

## Philippine Competition Commission Penalizes M&A Parties in its Maiden Decision on Non-Notification

### Recent Developments

On 19 February 2018, the Philippine Competition Commission (“PCC”) released its first ever decision on a case involving the non-notification to the PCC of an M&A transaction which met the thresholds for mandatory notification (the “Decision”). After finding that the parties consummated the transaction in violation of the notification requirements under the Philippine Competition Act (“PCA”), the PCC declared the transaction void, and imposed an administrative fine equivalent to 1% of the value of the transaction, solidarily on the acquiring and acquired entities, and their ultimate parent entities.

### Implications for Business in the Philippines

M&A transactions that meet the thresholds for mandatory notification under the Implementing Rules and Regulations of the PCA (“IRR”) must comply with the notification procedure, timelines and requirements under the IRR and the new Rules on Merger Procedure (“Merger Rules”). Please see our previous Client Alert on the Merger Procedure [here](#).

An M&A involving the acquisition of voting shares in a corporation must be notified to the PCC if it meets the Size of Person Test and the Size of Transaction Test. The latter requires that the value of the transaction exceeds PhP1 Billion<sup>1</sup>. To determine whether this test is met, the following are included in the valuation of the aggregate value of the assets in the Philippines that are owned by the acquired corporation or by entities it controls: (a) the assets of controlled corporations; and (b) shares in non-controlled entities. The valuation shall not include the acquired company’s shares in controlled corporations, to avoid duplication.

The consummation of a covered M&A that is not notified to the PCC may be subject to an administrative fine ranging from 1% to 5% of the value of the transaction, and the agreement shall be considered void. The PCC may consider aggravating and mitigating circumstances in the Merger Rules to determine the final amount of the fine.

The PCC may investigate a non-notification *motu proprio*, on the basis of information that may be provided by a third party.

### What the Case Says

#### *Background of the case*

The case involves Udenna Corporation’s (“Udenna”) purchase of 100% of the shares of KGL Investment Cooperatief U.A. (“KGLI Coop”) in KGL Investment B.V. (“KGLI – BV”) (collectively, the “Parties”) under a Share Purchase Agreement dated 28 July 2016 between Udenna and KGLI Coop, and a Deed of Transfer dated 19 August 2016, executed by KGLI Coop assigning its shares of stock in KGLI-BV in favor of Udenna for a consideration of USD 120 Million (“Transaction”).

At the time of the Transaction, KGLI-BV owned 39.71% of the shares in KGLI-NM Holdings, Inc. (“KGLI-NM”), a domestic corporation.

On 28 December 2016, the Mergers and Acquisition Office (“MAO”) of the PCC received a letter from Negros Holdings & Management Corporation, alleging that the Transaction was executed without compliance with the notification requirements under the PCA and its IRR. This prompted a fact-finding investigation by MAO on the Transaction by gathering publicly available information and documents, issuing and receiving various pleadings from the parties, and conducting conferences and meetings over the course of more than one year.

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<sup>1</sup> The thresholds for the Size of Person Test and Size of Transaction Test were increased by the PCC in Memorandum circular 18-001, which will take effect on 20 March 2018. The new relevant thresholds are Php5 billion and Php2 billion respectively.

## *Issue*

The Parties did not dispute the fact that they did not notify the PCC of the Transaction, or that the Parties had already consummated Udenna's acquisition of KGLI Coop's shares in KGLI-BV through the Deed of Transfer.

The only issue for resolution was whether or not the Transaction breached the notification thresholds under the IRR.

### *Notification Threshold for mandatory notification with the PCC*

Under the IRR, parties to an M&A must notify the PCC if the transaction meets the Size of Person Test and the Size of Transaction Test.

The Size of Person Test will be met if the aggregate annual gross revenues in, into or from the Philippines, or value of the assets in the Philippines of the ultimate parent entity of at least one of the acquiring or acquired entities, including that of all entities that the ultimate parent entity controls, directly or indirectly, exceeds PhP1 Billion<sup>2</sup>.

In this case, the Size of Person Test was satisfied because Udenna categorically admitted in its Answer with the PCC, that its assets, as the ultimate parent entity, and the assets of its subsidiaries have an aggregate value that exceeds PhP1 Billion.

The Size of Transaction Test for an acquisition of voting shares of a corporation is satisfied in the following cases:

- i. If the aggregate value of the assets in the Philippines that are owned by the corporation or non-corporate entity or by entities it controls, other than assets that are shares of any of those corporations, exceed PhP 1 Billion;  
or
- ii. The gross revenues from sales in, into, or from the Philippines of the corporation or non-corporate entity or by entities it controls, other than assets that are shares of any of 10 those corporations, exceed PhP 1 Billion;  
and
- iii. If as a result of the proposed acquisition of the voting shares of a corporation, the entity or entities acquiring the shares, together with their affiliates, would own voting shares of the corporation that, in the aggregate, carry more than the following percentages of the votes attached to all the corporation's outstanding voting shares:
  - a) Thirty-five percent (35%),  
or
  - b) Fifty percent (50%), if the entity or entities already own more than the percentage set out in subsection (a) above, as the case may be, before the proposed acquisition;

The main point of contention was the interpretation of the underlined phrase above which excludes 'assets that are shares of any of those corporations' from the aggregate value of the assets that will be measured against the PhP1 Billion<sup>3</sup> threshold.

## *Decision*

The PCC disagreed with the Parties and affirmed the interpretation of MAO that the aggregate value of the acquired company's assets must include the value of the assets of its controlled entities. However, such valuation will exclude the value of *shares* held by the acquired company in its controlled entities to avoid double counting of assets of the acquired company in its controlled entities. The reason for excluding the value of the acquired company's participating interest in its controlled entities is that the value of the *assets* of the controlled entities already forms part of the computation.

In addition, the value of the acquired company's shares in entities that it does *not* control must be included in the valuation of the aggregate value of the assets of the acquired company. Otherwise, the value of the acquired company's participating interest in such non-controlled entities will not be properly reflected in the valuation of the acquired company's assets. As applied to the case, the PCC explained that because KGLI-BV, as the acquired company, did not have control over KGLI-NM at the time of the transaction, the aggregate value of the assets of KGLI-BV required the inclusion of the value of its shares in KGLI-NM in the computation.

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<sup>2</sup> Ibid.

<sup>3</sup> Ibid.

Therefore, KGLI-BV's 39.71% interest in KGLI-NM amounting to USD 41,791,704 or Php 1,966,717,590.24 should be included in the value of the transaction, and the aggregate value of the assets of KGLI-BV exceeded the Php1 Billion threshold triggering the mandatory notification requirement.

#### *Penalty and Mitigating Circumstances*

In light of the PCC's finding that the Parties consummated the Transaction without complying with the notification requirements under the PCA and IRR, it imposed an administrative fine of Php 19,667,175.9 (approximately USD 418,450), solidarily on the parties, and considered the Transaction void.

With regard to declaring the Transaction is void, the PCC in the Decision stated that it has no discretion to refrain from imposing the void penalty as the same is provided under the PCA and the IRR. In a dissenting opinion, a PCC Commissioner did not agree with the position taken by the majority on the basis that the PCC should have exercised restraint in applying the void penalty. The dissenting opinion cites, among other reasons, the ambiguity of the phrasing in the PCA, the deficiency of the IRR as to how a voided agreement will be applied, implemented and monitored, and the circumstances of the subject Transaction.

In determining the amount of the administrative fine, which may range from 1% to 5% of the transaction value under the IRR, the PCC considered the fact that the Parties actively cooperated during the investigation of the violation beyond what is normally required. Apart from diligently submitting pleadings required under the rules, the Parties promptly appeared in all conferences called by the PCC, and voluntarily submitted documents to aid the PCC in its resolution of the case. In light of this, the PCC adjusted the penalty from the basic fine of 3% of the transaction value to 1%.

#### **Actions to Consider**

Parties to an M&A should carefully review whether the transaction meets the thresholds for mandatory notification under the IRR. In the event of uncertainty as to the rules that will apply to their transaction, it would be prudent for parties to seek legal advice, and / or request for a pre-notification consultation with the PCC, before proceeding with the transaction.

Parties that consummate an M&A transaction that meets the thresholds for mandatory notification without notifying the PCC, will be liable for the twin penalties of (i) an administrative fine ranging from 1% - 5% of the value of the transaction; and (ii) the transaction shall be considered void. The determination of the administrative fine may be adjusted accordingly in case of the presence of certain mitigating or aggravating circumstances.

#### **Conclusion**

The Decision is a clear indication that the PCC intends to enforce the full force of the PCA and the IRR in case of violations. The PCC, in its Decision, explains that the penalties associated with non-compliance with its rules on notification procedure, are primarily intended to deter parties to an M&A transaction from non-compliance with the notification requirements under the PCA.



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