Chinese Overseas Acquisitions: The Nokia Siemens/Motorola Case

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Background Brief: Chinese Overseas Acquisitions: The Nokia Siemens/Motorola Case

Executive summary

In 2010 Nokia Siemens Networks announced its intention to buy the wireless network equipment assets of Motorola Solutions. The deal was blocked by Huawei, the leading Chinese telecommunication equipment manufacturer. The dispute stemmed from an agreement dating back to 2001 under which Motorola resold some of Huawei’s gear outside of the United States.

Huawei’s slogan “We see beyond telecom” may be a tribute to its technological competence and marketing savvy. The firm’s ambitions have ignited the US government’s suspicions that it may have links with the Chinese military. These alleged ties have derailed a series of technological acquisitions the Shenzhen-based telecommunication equipment manufacturer intended to make in the United States. Whether the target of the acquisition is a start-up or a large player, whether the technology is broadband networks or cloud computing, Huawei seems to be finding the Committee on Foreign Investment in the United States (CFIUS) on its acquisition path.

Main points

- A number of Chinese firms are proving to be formidable competitors to established telecommunications equipment manufacturers. They nonetheless struggle to gain a foothold in certain markets (e.g., USA and India) for security and intellectual property concerns
- Huawei as well as other national champions with global ambitions are learning to play the game of intellectual property rights both in markets and in courts
- China’s anti-monopoly law is impacting the merger and acquisitions conducted by multinational firms in China and abroad. The duration of review can become a real issue for merging parties
- In addition to its established industrial policy, the Chinese government is likely to respond in a quid pro quo manner to protectionist measures encountered by its national champions abroad
Case background

In July 2010, Nokia Siemens Networks (NSN) announced its acquisition of the wireless network equipment assets of Motorola Solutions (MSI). The deal was subsequently approved by both US and EU regulators but it did not close at the time for two reasons. First, Huawei sued MSI and NSN on the grounds that MSI had not provided adequate assurances that Huawei’s technology and intellectual property (IP) would not be leaked from MSI to NSN – Huawei had been a Motorola OEM/private label manufacturer for wireless equipment since 2000. Huawei wanted the deal to exclude any equipment based on GSM (Global System for Mobile Communications) and UMTS (Universal Mobile Telecommunications System) technology standards. It claimed that it developed, designed and sold technologies, and other products, to Motorola which resold them under its own brand. Huawei alleged that, through cooperation, Motorola obtained confidential information on Huawei’s products. Following MSI’s acquisition by NSN, Huawei feared that its confidential information would be transferred to the latter. Viewing NSN as a direct competitor, Huawei sued to prevent the information transfer under the conditions proposed by NSN. A US Federal District Court granted Huawei’s request for a preliminary injunction. One of the reasons behind Huawei’s lawsuit is that the deal with Motorola would have pushed NSN well ahead of Huawei in the network equipment market, whereas the rivals are currently neck-and-neck for second place (behind Ericsson).

Second, the Chinese Ministry of Commerce’s (MOFCOM) anti-monopoly bureau took its time to grant anti-trust approval. In March 2011, the bureau extended its review of the bid for another 60 days. MOFCOM consulted both telecommunication operators and network equipment suppliers over NSN’s planned acquisition of Motorola’s assets. Under this consultation, Huawei informed the regulator that it opposed a completion of the deal as long as its dispute with Motorola was unresolved.

The sale finally went through in April 2011. MSI agreed to dismiss Huawei as a defendant in the legal dispute over misappropriated IP, while Huawei agreed to allow the transfer of its commercial agreements with MSI to NSN for a one-time fee, and to provide NSN with access to confidential information in order to support and service Motorola networks already deployed on Huawei hardware.

The Huawei puzzle

With sales in 2010 of CNY 185.2 billion (EUR 19.9 billion1), a year-on-year increase of 24.2%, Huawei is without doubt the leading Chinese telecommunication equipment manufacturer. Its products are found both at home and abroad. Its 2010 sales revenue from overseas markets amounted to CNY 120.4 billion (EUR 12.9), up 33.8% from the previous year. In other words, Huawei sells twice as much abroad as in China, indicating its drive to capture markets and take established multinational equipment manufacturers head-on.

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1 Exchange rate as of June 14, 2011: EUR 1 = USD 1.43 and EUR 1 = 9.30
If one is to believe the firm’s annual report, the Shenzhen-based firm invested CNY 16.5 billion (EUR 1.8 billion) in R&D in 2010, an increase of 24.1% year-on-year. More than 50,000 employees (46% of the total workforce) are currently engaged in R&D. 20 research institutes have been established across the world including the USA, Germany, Sweden, Russia, India and China. They are complemented by a number of joint innovation centres with leading telecommunication operators. At the end of 2010, Huawei had accumulatively filed 49,040 patent applications (of which 3,869 were patent applications in China, 8,892 were international patent applications under the Patent Cooperation Treaty, and 8,279 were overseas patent applications). Of the 17,765 authorised patents granted, 3,060 were overseas patents. Huawei’s presence is also increasingly felt in international standardisation groups. By the end of 2010, the firm was a member of 123 standards organisations, including 3GPP, IETF, ITU, OMA, NGMN, ETSI, IEEE and 3GPP2. In 2010, Huawei also increased its patent portfolio in the USA, either by purchasing patents (e.g. from the network equipment maker Avici Systems) or by filing for patents based on its own technology.

While customers express great satisfaction with Huawei’s products, the firm’s relentless expansion abroad means that it has encountered a number of political obstacles - its ambitions have ignited the US government’s suspicions that it may have links with the Chinese military. The company has consequently had to renounce several deals in the United States, having to back out on the grounds of national security and intellectual property. Huawei’s bid for US broadband network software maker 2Wire was rejected even though it was significantly higher than the winning bid in monetary terms. It also tried to buy equipment maker 3Com with US-based Bain Capital in 2007, but the plan was blocked by the US government’s Committee on Foreign Investment in the United States (CFIUS) over concerns that Huawei had ties to the Chinese military. Huawei also sought to acquire assets from Nortel but lost to Sweden’s Ericsson on questions of intellectual property rights infringement. Similarly, when the Shenzhen-based firm set out to supply telecom equipment to Sprint Nextel, some senators were concerned that this might create substantial risk for American companies and possibly undermine national security. Finally, in May 2010, the Chinese firm paid USD 2 million (EUR 1.4 million) to acquire the staff and intellectual property of 3Leaf Systems, a start-up working on cloud computing (i.e., the pooling of multiple server resources). Pentagon officials took the unusual step of asking the company to retroactively clear the deal with the CFIUS. On top of this, Huawei has also faced significant difficulties in penetrating the strategic accounts of other countries - for instance, reports of the recent tie-up between Huawei and the Bangalore-based Indian Institute of Science once again raised security concerns.

As the firm is not listed on any stock exchange, and given the opaqueness of firm ownership in China, it is extremely difficult to formally establish how close Huawei actually is to the Chinese government and military. According to its annual report, Huawei Technologies Co., Ltd. is a wholly-owned subsidiary of Shenzhen Huawei Investment & Holding Co., Ltd. The latter is solely owned by its employees without any third parties (including government bodies) holding any of its shares. In any case, informal connections to the Chinese military or any agency matter as much as formal ownership when it comes to security concerns. Strong relationships between firms and military agencies are not unheard of in Western countries in particular when it comes to telecommunication systems.
Protectionism abroad and at home

One of the reasons why the NSN-MSI deal took so long is that, in order to comply with antimonopoly regulations, Motorola needed to gain approval from the governments of nine countries and regions where it had assets, including the United States, the European Union, China, Brazil and Japan.

Chinese anti-monopoly law (AML) took effect on August 1, 2008. It has served mainly as a mechanism to block or attach conditions to large mergers. Under AML, companies with annual turnovers of RMB 10 billion (EUR1.1 billion) globally and RMB 400 million (EUR 43 million) in China, or combined turnovers of USD 2 billion (EUR 1.4 billion) in China, must get anti-trust approval for a proposed deal from the Chinese government. Once MOFCOM is satisfied that a submitted filing is complete, it conducts a review (commonly referred to as a ‘Phase I’ review) for up to 30 calendar days. If MOFCOM identifies serious issues to consider further, it may notify the concerned parties before the end of the 30 day deadline that it will be conducting an extended (Phase II) review. Where no such decision is conveyed to the parties during the Phase I period, approval is deemed to have been provided at the end of 30 days. Where MOFCOM notifies the parties that it will conduct a Phase II review, this review must be completed within 90 calendar days (although the deadline may be extended up to an additional 60 days, if: the parties consent, the submitted documents are inaccurate or require further verification, or relevant circumstances significantly change after the initial notification). Accordingly, MOFCOM’s formal review process in relation to notified deals can last up to 180 days. In China, enforcement agencies are granted much greater power than those in western countries and their actions are not usually subject to effective judicial review. A number of multinationals have complained about the slow pace and transparency of the evaluation and review process. In the case of Panasonic’s takeover of Sanyo, the ministry accepted the filing four months after the company first lodged its file.

In principle, MOFCOM has exclusive jurisdiction over merger control in China. Extraterritorial jurisdiction will only be conferred on the Chinese competition authorities should the transaction have the potential to exert negative influence on competition in China. The current regime departs from the previous system, in place prior to the AML’s entry into force, in which MOFCOM shared responsibility for merger review with the State Administration for Industry and Commerce. The Chinese anti-monopoly bureau is gaining influence in global mergers and acquisitions. It has set conditions for big transactions, including a requirement that Pfizer divest its Chinese swine-vaccine business as part of its acquisition of Wyeth and an antitrust probe that led to the block of Coca-Cola’s bid for China Huiyuan Juice Group in 2009.

Conclusion

Whether they are Japanese, American or European, disputes over intellectual property are a normal component of business for multinational companies (MNCs). The Nokia Siemens/Motorola case illustrates a new trend, i.e. Chinese firms are taking IP issues to court. The lawsuits that Huawei and ZTE (a rival Chinese telecommunication equipment manufacturer) recently filed against each other on the
grounds of IP infringement indicate that the battle for IP does not solely pitch Chinese firms against MNCs. However, a deal running against the interests of a firm considered a domestic innovation powerhouse - at a time when China was promoting the development of domestic technology through its “indigenous innovation” program - was bound to draw attention from the government. In fact, MOFCOM has repeatedly complained that the US government is using the CFIUS process as a pretext for damping Chinese investment in the United States. Not surprisingly China has recently unveiled its own foreign investment review process.

The case also signals that a number of Chinese firms are building valuable intellectual assets and will go to great length to defend them. In fact, one could argue that past litigation (e.g., with Cisco) directly stimulated the formulation of Huawei’s intellectual property rights (IPR) strategy to “protect and utilize autonomous IPRs, respect IPRs of others, improve core competence and strongly support global product strategy”. The strategy is central to keep enhancing Huawei’s brand and to move away from its low-cost vendor image.

Finally, the case highlights a number of points regarding Chinese firms venturing abroad. First, when Chinese firms have established IP rights under Chinese law and contracts with parties in the US or elsewhere, it is important for them to understand the scope of their IP rights under all of the potentially relevant legal regimes. Second, claims for preliminary injunctive relief before national courts can be critical to the outcome of a dispute, even where a contract provides for private arbitration. Huawei made the point that it would be futile to wait for an arbitral tribunal to form because the potential infringements may have already caused irreversible harm before the tribunal was appointed. In other words, overseas courts can help Chinese firms protect their legitimate rights in their overseas dealings.

In summary:

- Huawei has emerged as a serious competitor in the market for telecommunication equipment. Having cut its teeth in emerging markets, it is now in a position to offer products of high quality and at very competitive prices to established telecommunication service providers. Firms like British Telecom are rolling out some of their next-generation networks with Huawei products

- Some Chinese firms are starting to put intellectual property and the rights that come with it at the centre of their business strategy. While investing large amounts in research and development, Chinese telecommunication national champions are on the lookout for technologies that complement their offerings

- Chinese firms are getting more astute at navigating the legal system abroad; while distinct, the reciprocal lawsuits and the protracted review by MOFCOM of the NSN acquisition illustrate the ambitions of Chinese national champions and the backing they can get from the State

- All types of onshore and offshore mergers, equity and asset acquisitions, and other arrangements that involve companies acquiring control (including joint ventures) could be subject to merger reviews in China; business deals directly or indirectly involving Chinese national champions (like Huawei) have a high chance of attracting the attention of government officials
- The Chinese anti-monopoly bureau may not represent a true barrier to global mergers and acquisitions (M&A), but it is difficult to predict how the Chinese government will behave whenever a national champion is affected by the deals; companies planning mergers or acquisitions should plan their transactions with MOFCOM’s review in mind; high-level exchange between China and the EU on M&A review procedure may ease transactions by providing more transparency.

- So far Huawei seems to have faced less resistance deploying its activities in Europe than in the United States or India; this may however change if the firm embarks on “sensitive” IP acquisition from European firms or research institutions.