Illegal Parking?

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On 27 June 2019, the European Commission (Commission) announced it had fined Japanese camera and printer manufacturer, Canon, €28m for partially implementing its 2016 acquisition of Toshiba Medical Systems prior to the transaction being notified to the Commission and, as a result, before it had been formally given competition clearance. The focus of concern was the use of a so-called 'warehousing structure' – a two-step process during which the target company is temporarily "parked" with an intermediary buyer with the intention, the Commission claims, of circumventing EU merger control rules (rules requiring merging parties to notify and suspend implementation of their transactions pending approval).

The Commission's actions may come as no great surprise to some in that they confirm the Commission's long-held view that warehousing structures risk violating the EU rules governing mergers. Indeed, this point was made explicit when the Commission issued an updated *Consolidated Jurisdictional Notice* in 2008 – in particular, confirming that such transactions should be viewed as one single concentration with the intermediary stage merely being the first step towards implementation of the concentration.

This view, however, sits somewhat at odds with the findings of the EU Courts, which have previously confirmed the legality of such arrangements on the basis that the intermediary entity does not necessarily acquire 'control' over the warehoused company or assets. This potential discrepancy in views will no doubt become the focal point of Canon's anticipated challenge before the General Court – the essential questions being:

– to identify circumstances in which a 'concentration' is deemed to be 'implemented' within the meaning of Article 7(1) EU Merger Regulation (EUMR); and (as part of this)

– whether the intermediary warehousing could be viewed as an action which contributes to, and is necessary for (ie is not merely "ancillary or preparatory") the change in control of the target (as per the Court of Justice's ruling last year in *Ernst & Young*) and, as such, forms the first step in implementing the concentration.

Merger control – procedural gun-jumping

Article 7(1) EUMR requires parties acquiring control of a business in a qualifying transaction (a so-called concentration with an EU dimension) to notify their transaction to the Commission for approval. The provision also prohibits the transaction from being implemented before it has been approved by the Commission – infringing conduct otherwise known as 'gun-jumping'.

Such procedural gun-jumping typically involves conduct falling short of actually taking formal ownership over a target's shares and assets and, instead, often entails more subtle measures that might be construed as prematurely transferring control over the target to the purchaser. The obligation to suspend the closing of a qualifying transaction exists regardless of whether or not the proposed merger creates potential substantive competition concerns – and the fact that a transaction may then receive competition clearance does not protect it from any potential prior violation of the standstill obligation.

Strict enforcement against procedural breaches of merger control rules, in particular failure to observe the standstill obligation, is very topical at the moment – with the Commission and other competition authorities investigating and/or imposing significant fines for gun-jumping in a number of high-profile cases. This

includes the Commission's *Altice/PT Portugal* infringement decision, issued on 24 April 2018, which fined the Dutch telecommunications company Altice €124.5m for an alleged infringement of the standstill provisions.

Background

In August 2016, Canon notified its planned acquisition of Toshiba Medical Systems to the Commission – with the Commission clearing the deal unconditionally the following month. However, before notifying the transaction to the Commission, there was an arrangement whereby an interim buyer purchased 95% of the target's shares for the nominal amount of €800. As part of this first step, Canon also paid €5.28 billion for the remaining 5% of the shares and share options over the interim buyer's stake (including a non-voting share providing it veto rights over any decision by the interim buyer to sell Toshiba Medical Systems to a different ultimate buyer). Only after the transaction was cleared by the Commission was the second step executed in which Canon exercised its share options and thus acquired 100% of the shares in Toshiba Medical Systems.

The parties had entered into this arrangement due to financial difficulties suffered by Toshiba Medical Systems' parent company, Toshiba, following its much publicised auditing issues. In short, Toshiba needed to close certain aspects of the transaction quickly to recognise financial benefits in a time-frame that would not accommodate prior receipt of all relevant merger control clearances. The warehouse structure was intended to facilitate an interim transaction so as to allow Toshiba to complete its sale of the medical system business promptly, without the need to wait for the Commission review process to be concluded.

Despite clearing the notified transaction, the Commission soon began looking into the arrangements entered into before the transaction was notified. Following the issuing of two Statement of Objections to Canon, the Commission concluded that the first step of the arrangement amounted to partial implementation of the transaction – insofar as it contributed to (and was necessary for) the ultimate change of control of the target at the second step of the process. In other words, the first and second steps in the transaction structure effectively formed a single concentration – and the first warehousing step was not, as intended, a separate stage at which the concentration with Canon did not arise.

On the basis of the above analysis, the initial measures should have been notified to the Commission for approval before being put into place. Canon therefore, according to the Commission, violated both the notification requirement and the standstill obligation under Article 7(1) EUMR.

End of the story?

Based on public statements, it seems likely that Canon will challenge the Commission's decision before the General Court. The focus there will then be on the main principles that can be distilled out of last year's *Ernst & Young* ruling handed down by the Court of Justice.

In its *Ernst & Young* judgment, the Court of Justice clarified that there is no breach of the standstill obligation on account of transactional activity pursued prior to a merger's clearance where such activity does not contribute to (and is not necessary in order to achieve) a change of control on a lasting basis of the target entity – and regardless of whether that activity results in market effects. Such "ancillary or preparatory" acts, whether or not they generate market effects, do not create a "direct functional link" with a proposed merger's implementation.

Accordingly, such arrangements are unlikely to undermine the objective of the EUMR's standstill provisions – namely, to exercise effective oversight over qualifying transactions *before* they produce lasting changes in market structure.

The Court of Justice's ruling was particularly helpful insofar as it re-centred the potentially amorphous category of behaviour constituting 'gun-jumping' around the central concept of a 'change of control' leading to the implementation of a concentration. In that regard, the Court of Justice's distinction between actions contributing to a change of control and mere preparatory actions is a useful delineation (at least in principle).

However, it will be interesting to see how this might be applied to the facts of the *Canon* case – in particular, whether the General Court agrees that the first warehousing step can be construed as 'partial implementation' of a notifiable concentration. In other words (and as governed by the principles identified in *Ernst & Young*), can the intermediary 'parking' of the business being sold be viewed as an action which contributes to, and is necessary for – rather than being merely "ancillary or preparatory" – a "*change in control on a lasting basis*" of the target entity?

Conclusion

The recent spate of gun-jumping investigations by various competition authorities underscores their determination to make compliance with the procedural merger rules a key enforcement priority, whilst also illustrating the risks companies face for failing to meet such requirements.

This most recent case also highlights the dangers involved in using a warehousing structure to facilitate a deal – despite the potential inconsistency that exists between relevant EU jurisprudence on the issue and Commission decisional practice. Indeed, even if arguably permissible under relevant EU law (and even if Canon were to be successful with its appeal before the General Court), global deals may nevertheless encounter difficulties justifying such an approach with other relevant competition authorities that also have jurisdiction to review (noting that Canon was also fined by a number of other authorities for this specific arrangement). In short, at least for large cross-border transactions, there remains a significant risk in pursuing such a strategy, notwithstanding commercial pressures that can arise to do so.

Mark Jones

Partner, London, Brussels

T +44 20 7296 2428

mark.jones@hoganlovells.com

Matt Giles

Senior Professional Support Lawyer, London

T +44 20 7296 2155

matt.giles@hoganlovells.com

Alicante
Amsterdam
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