# *PARTIAL IMPLEMENTATION AND GUN-JUMPING, HOW ORIGINAL. WHAT WILL THEY THINK OF NEXT?* – CHAPTER TWO*

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## I. INTRODUCTION

Following a Chapter One of this Article[1], where some questions on the Canon/Toshiba Medical Systems Corporation ("TMSC") merger infringement case were raised, we now move on to Chapter Two.

On 22 October 2019, the European Commission ("Commission") published its awaited Decision of 27 June 2019 in the TMSC merger infringement case (hereinafter referred to as "Commission's Decision" or "Canon/TMSC case")[2], in which confirmed that Canon breached the EU Merger Control Regulation ("EUMR")[3] by (partially) implementing a transaction before its due notification. Canon was fined in €28 million.

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* This title is based on an iconic sentence "*A gun in a bag of peanuts, how original. What will they think of next?*" from a 007 James Bond movie "*The Man with the Golden Gun*". **Key-Words:** Regulation and Business Law; Antitrust Law; Illegal Behaviour and the Enforcement of Law.

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1 "*Partial Implementation and Gun-Jumping, how original. What will they think of next?* – Chapter One", *in Revista de Regulação e Concorrência*, Vol. 37, 133-143.

2 Case M.8179 – *Canon / Toshiba Medical Systems Corporation*, Article 14(2) Regulation (EC) 139/2004 Decision of 27 June 2019 available at:
https://ec.europa.eu/competition/mergers/cases/decisions/m8179_759_3.pdf.

3 Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, OJ L 24, 29.1.2004, p. 1-22.

Canon used a so-called "warehousing" two-step transaction structure involving an interim buyer which, according with the Commission's Decision, essentially allowed it to anticipate its acquisition of TMSC prior to notification and obtaining the relevant merger approval from the Commission.

The singularity of this case is that the implementation of the transaction was only partial, and took place in the context of a two-step transaction structure where only the first stage was implemented before notification and clearance. According to the parties, only in the second stage of the transaction control over TMSC was effectively acquired by Canon.

Following a description of the factual background in both underlying cases[4] and the possible legal assessment in the scope of the European Union's jurisprudence made in Chapter One, Chapter Two will namely analyze the Commission's Decision and attempt to extract some guidelines on gun-jumping regarding early implementation of concentrations and warehousing schemes.

In Chapter One, before the Commission´s Decision, some questions were raised: *could a concentration be deemed implemented even though there was no actual acquisition of contro*l? *Does the notion of implementation fully overlap with the one of actual acquisition of control*? When should the acts in question be considered as *leading to a transfer of control*?

In Chapter Two we will see how the Commission´s Decision addresses these questions in the Canon/TMSC case.

## II. FACTUAL BACKGROUND

As Toshiba was, apparently, experiencing substantial financial difficulties, it invited outside majority shareholders into TMSC in exchange for cash. With this purpose, Canon submitted its bidding proposal, offering a transaction structure under which it would irreversibly pay Toshiba the full purchase price, but would not acquire actual control over TMSC before having had obtained the necessary regulatory clearances.

Toshiba accepted Canon's proposal that fulfilled its need for immediate income, and, for the purposes of this transaction, a vehicle company (MS

4 M.8006 – *Canon/Toshiba Medical Systems Corporation (TMSC)*, approved by the Commission on 19.09.2016 (available at https://ec.europa.eu/competition/mergers/cases/decisions/m8006_241_3.pdf) and the infringement proceedings set out in M. 8179 – *Canon/Toshiba Medical Systems* (art. 14.2 proc.).

Holding) was created with an independent board of directors from Canon and Toshiba.

Canon irrevocably paid Toshiba the agreed price in return for one non-voting share (Class B) and 100 share options attached to TMSC ordinary, Class C, share capital. The share options could only be exercised once all regulatory proceedings had been completed. MS Holding and Toshiba entered into a share transfer agreement and MS Holding paid Toshiba for 20 TMSC voting shares (Class A).

All these events occurred in March 2016 and are referred to as the *Interim Transaction* in the Decision[5].

Following notification in August 2016, the Commission approved the transaction in September. In December 2016, after receiving all regulatory approvals, Canon exercised its share option, acquiring, therefore, actual control over TMSC (the *Ultimate Transaction*)[6].

Therefore, this transaction was structured in a way that the share option was certain to be exercised, and the full value of the price was paid at the moment the option right was acquired, without any further payment. Thus, this option right did not tantamount to a premium corresponding to the value of the option, it corresponded instead to the value of the shares itself.

## III. CANON'S INFRINGEMENT

### *(i)* Legal Framework

The Commission's Decision starts by referring that the EUMR provides for an *ex-ante* merger control regime applicable to concentrations which are deemed to arise where there is a *change of control on a lasting basis* (Article 3(1) EUMR)[7].

It then follows that the EUMR provides for an obligation to notify concentrations prior to their implementation (Article 4(1) EUMR) and also prohibits the implementation of concentrations before their notification and clearance by the European Commission (Article 7(1) EUMR).

As for the *notion of concentration*, while it generally encompasses one single transaction, the concept of concentration within the meaning of Article 3

5 *Cfr*. Commission's Decision, §36.

6 *Ibid*.

7 *Cfr*. Commission's Decision, §71.

of the EUMR may encompass several legally distinct but closely connected transactions.

As such, the EU Courts have confirmed on several occasions that separate transactions ought to rightly be treated as part of a "*single concentration*" to the extent that the economic reality underlying these transactions leads to such a conclusion.[8]

To determine whether several transactions form part of a single concentration, the Consolidated Jurisdictional Notice[9] also confirms that single concentrations can result from successive separate transactions but where the nature of the first transaction(s) is only transitory.

The concept of single concentration is enshrined in recital 20 of the preamble to the EUMR stating: "[i]*t is moreover appropriate to treat as a single concentration transactions that are closely connected in that they are linked by condition or take the form of a series of transactions in securities taking place within a reasonably short period of time*".

Hence, it can be learned from the Commission's Decision that it is irrelevant whether control was acquired in one, two or more stages by means of one, two or more transactions to the extent the end-result of the transactions is the acquisition of control over the target[10].

As for the notion of "*implementation*", the Commission starts to acknowledge that it is not explicitly defined in Articles 4(1) and 7(1) EUMR[11].

However, it then reminds that, in *Ernst and Young*[12], the Court of Justice sets out that the notion of "*implementation*" must be interpreted by reference to the "*purpose and general scheme*" of Articles 4(1) and 7(1) EUMR, which is to preserve the *status quo ante* until a concentration has been formally notified to, and declared compatible with the internal market, by the European Commission[13].

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8 *e.g.*, in Case T-282/02, *Cementbouw Handel & Industrie v Commission,* EU:T:2006:64, sets out in paragraph 5 that regard should be given to "*the economic aim pursued by the parties, by examining, when faced with a number of legally distinct transactions, whether the undertakings concerned would have been inclined to conclude each transaction taken in isolation or whether, on the contrary, each transaction constitutes only an element of a more complex operation, without which it would not have been concluded by the parties.*"

9 *Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No. 139/2004 on the control of concentrations between undertakings*, §28-35. *OJ* C 95, 16.4.2008.

10 *Cfr*. Commission's Decision, §101.

11 *Ibid* §82.

12 Judgment of 31 May 2018, C-633/16, *Ernst & Young*, EU:C:2018:371.

13 *Cfr*. Commission's Decision, §§82-83.

The Commission refers that the *Ernst and Young* judgment also explicitly clarified that partial implementation falls within the scope of Article 7(1) EUMR[14].

Indeed, *Ernst and Young* provides that "*it is appropriate to treat as a single concentration transactions that are closely connected*"[15], *i.e.* excluding transactions that are not necessary to achieve a change of control of an undertaking concerned by that concentration (ancillary or preparatory transactions that do not present a direct functional link with its implementation).

The Court in the referred judgement[16] also clarified that to determine whether there is early implementation, transactions carried out in the context of a concentration should be considered "*necessary to achieve a change of control*" over the target undertaking if they "*present a direct functional link with [the] implementation*" of the concentration and "*it is appropriate to treat as a single concentration transactions that are closely connected*".

The Court also clarified that "*those transactions, although they may be ancillary or preparatory to the concentration, do not present a direct functional link with its implementation, so that their implementation is not, in principle, likely to undermine the efficiency of the control of concentrations*". Thus, the Court made clear that, in order to determine if there is early implementation, transactions carried out in the context of a concentration should be considered "*necessary to achieve a change of control*" over the target undertaking if they "*present a direct functional link with [the] implementation*" of the concentration.[17]

Based on these considerations, the Commission in its Decision refers that the Court concluded "*that Article 7(1) of Regulation No 139/2004 must be interpreted as meaning that a concentration is implemented only by a transaction which, in whole or in part, in fact or in law, contributes to the change in control of the target undertaking*". This sentence is crucial for assessing the boundaries of gun-jumping.

Lastly, the Commission highlights that the Court in said judgement did not limit this to transactions having effects on the market, as it clarified that "*it cannot be ruled out that a transaction having no effect on the market might*

14 *Ibid* §91.

15 *Ernst & Young* Judgement, §48.

16 *Ibid* §87.

17 Reference made in the Commission's Decision, §§48-49.

*nevertheless contribute to the change in control of the target undertaking and that therefore, at least partially, it implements the concentration*".[18]

***(ii)* Application of the previous considerations to the case**

Having established the above, the Commission decided that the Interim and Ultimate Transactions, despite being legally distinct, assembled constituted a single concentration within the meaning of Article 3 of the EUMR. The Commission considered thus both transactions inherently closely connected and forming part of a single economic project[19].

Following this rationale, the Commission considered that the Interim Transaction constituted a partial implementation of the overall transaction since contributed (at least in part) to the change in control of TMSC. By carrying out the Interim Transaction, Canon partially implemented the single concentration consisting in the acquisition of sole control over TMSC by Canon.

Thus, since Canon partially implemented the concentration consisting in the acquisition of sole control over TMSC prior to notification to and clearance by the Commission, it breached both Articles 4(1) and 7(1) EUMR.

Central to this conclusion was the consideration that the Interim Transaction was only undertaken in view of the Ultimate Transaction and should be deemed as a single economic project, since Canon, and not MS Holding, participated and won the bidding process for TMSC.

Canon was also the one proposing the transaction structure, which predetermined it as the ultimate buyer of TMSC. The share transfer agreement between Toshiba and MS Holding was conditional upon the execution and enforceability of the agreement between Toshiba and Canon.[20]

Furthermore, the Commission concluded that Canon would never have to make an irreversible payment if it were not for the Ultimate Transaction. Thus, from the outset, the sole purpose of MS Holding was only to facilitate

18 Commission's Decision, §88.

19 *Ibid* §99.

20 *Cfr.* Commission's Decision, §§118-125.

the acquisition of control by Canon over TMSC[21]. Canon was always meant to be the ultimate acquirer of TMSC whatsoever.[22]

As for the opinion of the Advisory Committee on Concentrations pursuant to Article 19 of the EUMR, all the Member States participating in the Advisory Committee of the Canon/Toshiba case supported the Commission's Decision[23], which may suggest that future similar cases in their own jurisdictions could have a similar outcomes.

Canon appealed the Commission's Decision to the EU General Court (pending Case T-609/19)[24].

### *(iii)* Conclusion

According to the Commission's Decision and following *Ernst & Young* judgement, the *standstill obligation* under the EUMR prevents merging parties from taking measures that amount to partial implementation when the measures in themselves present a *direct functional link* to the implementation, *i.e.* are measures deemed as *necessary to achieve a change of control*.

This Decision further confirms that purely ancillary or preparatory measures taken in the context of a transaction, that are not necessary for the acquisition of control over the target, will not be deemed as measures necessary for the acquisition of control whatsoever.

To sum up and trying to respond to the questions raised in Chapter One of this Article, the Commission does not dissociate the concept of implementation of a concentration from the acquisition of control, but widens this last concept to *any act contributing to a lasting change of control*, even though the act in itself does not confer actual control.

Therefore, even operations that fall short of acquisition of control may give rise to the implementation of a concentration, as long as they present a direct functional link with the single economic project.

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21 Furthermore, Canon proposed and actively participated in the setting up of MS Holding (including the design of its corporate structure). MS Holding had no economic interest in TMSC beyond its role as interim buyer for which it was remunerated at a fixed price (*cfr*. §§126 ss).

22 In this sense, the Commission refers that Canon was the only party that could ultimately dispose of TMSC's controlling shares, and it would not have had such influence before the acquisition of sole control over TMSC if the acquisition was not structured as a two-step warehousing scheme. Furthermore, it was granted to Canon a veto right that allowed it to pre-empt one of the legal rights of the majority shareholder. Also Canon bore the economic risk of the concentration from the start (*cfr*. §§131 ss).

23 *Cfr.* https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52019M8179(01)&from=EN.

24 *Cfr.* https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62019TN0609&from=EN.

## IV. GUIDELINES ON THE APPLICATION OF THE STANDSTILL OBLIGATION

This Commission's Decision and the recent Case Law have given some guidance on the application of the EU standstill obligation, and this may influence the interpretation of equivalent provisions in the national merger control laws of Members States.

It is therefore duly established that an act can infringe the standstill obligation if "*in whole or in part, in fact* or in law*, contributes to the change in control of the target*" and is "*necessary*" to achieve that change of control.

However, irrespective of the guidance that can be drawn from these rulings, it is fair to say that undertakings could still face some difficulties when drawing the line between what are legitimate preparatory measures and what is a partial implementation of a concentration.

In fact, defining what constitutes gun-jumping can be a challenging exercise, since many forms of pre-merger understandings between the parties represent a sound and essential collaboration during the transaction negotiations (*e.g.* due diligence processes), but on the other hand, parties must absolutely avoid to act as a single business unit or prematurely align incentives.

Also in certain cases, pre-merger information sharing, amongst other possible competition infringements (*e.g.* illegal information sharing), may also contribute to gun-jumping, for example cases where the buyer effectively gains beneficial ownership of the seller prior to regulatory approval of the transaction.

Advocate General Wahl's Opinion, in the *Ernst & Young* case, also recognizes this loophole[25] – "*the Court has to date not specifically ruled on the scope of the standstill obligation in Article 7(1) of Regulation No 139/2004*".

In this sense, Advocate General Wahl considers[26] that "*it would not be effective for the Court to set out in detail a general and exhaustive list of criteria with the aim of capturing all the possible measures that could potentially be caught by the standstill obligation. Characterising thus, in positive terms, the standstill obligation would run the risk of excluding certain measures, thereby potentially prejudging the outcome of future cases, to the detriment of both the Commission's activity as regulator and the Court's review thereof. Indeed, if the Court were to approve the use of certain criteria to positively demarcate the scope of the standstill*

25 Opinion of Advocate General Wahl delivered on 18 January 2018, available at: http://curia.europa.eu/juris/document/document.jsf?text=&docid=198531&doclang=EN.

26 *Ibid,* §§44-45.

*obligation, it might even narrow the scope of that obligation if those criteria were to be applied systematically and so as to be a priori determinative*".

It then continues, "(…) *Rather, a negative definition of the standstill obligation is to be preferred. That requires the Court to provide a definition of those measures that will not be caught by the obligation, thereby creating enhanced legal certainty for the undertakings concerned while at the same time retaining the flexibility necessary for effective merger control*".

Probably not the whole solution for the lack of specific boundaries on gun-jumping, but still in the specific case of Portugal, the Competition Act (Law 19/2012, 0f May 8) foresees an explicit instrument whereby parties can resort to the mechanism of pre-assessment. This informal procedure is intended to clarify any doubts on possible mandatory notifications and on any other matters related to the projected merger transaction.

## V. SOME FINAL REMARKS ON WAREHOUSING TRANSACTIONS AND GUN-JUMPING

Concluding this Chapter Two, we will make some final remarks regarding warehousing transaction structures and the standstill obligation.

Warehousing structures allow a faster sale, in particular when there is a pressing need to implement a transaction quickly, *e.g.* due to financial difficulties of the target or the seller. They are an important instrument for business and M&A activity.

Certain forms of warehousing – like the Canon/ TMSC transaction – are capable of breaching the notification and suspension obligations when not previously notified, since it is considered that an acquisition by the interim acquirer to be part of a single concentration[27]. This means that if the interim transaction is implemented before notification and clearance, it will infringe the standstill obligation.

The key concern with this kind of transaction is the assumption of economic risk by the ultimate purchaser; and if the ultimate acquirer already bears the economic risk or aligned strategies prior to clearance, the Commission or National Competition Authorities may consider it problematic.

27 With the exception set in Article 3(5)(a) of the EUMR, which provides that no concentration arises in case of temporary acquisitions of securities made by financial institutions in their ordinary course of business, subject to the securities being acquired with a view of reselling them and the financial institutions not exercising voting rights which would influence the competitive behaviour of the target.

Other warehousing structures are compatible with the standstill obligation and therefore are not to be condemned, and this is specifically acknowledged in the Commission's Decision[28]: it is stated that provided the share option is not certain to be exercised[29], and the full value of the price is not paid at the moment the option rights are acquired[30], then share options will continue to be treated as an acquisition of control only when exercised and not when the option right is acquired[31].

## VI. CONCLUSION

Notwithstanding some useful boundaries on gun-jumping that can be learned from the Canon/Toshiba warehousing case, practical guidance on the limits of some other important concepts may be still lacking, awaiting clarification in possible future decisions or specific gun-jumping guidelines issued by the Commission or National Competition Authorities.

We hope to have further Chapters about these boundaries in the near future.

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28 *Cfr*. Commission's Decision, §§139-141.

29 *Ibid "(…) In fact, when an investor gets the option to buy (shareholding in) a company, at that moment it does not normally pay the whole amount for the potential future acquisition of the shareholding (corresponding to the value of that shareholding), but only a premium corresponding to the value of the option (rather than the value of the shares itself). By the expiry date of the option, the holder can decide whether to exercise the option taking into account the contemporaneous value of the company. Until that time, the holder of the call option only bears the economic risk for the premium paid.",* §139.

30 *Idem ibid "(…) After pre-paying the full amount, Canon also acquired the right to become (without any further payment) the sole shareholder of TMSC or alternatively to determine the ultimate acquirer of TMSC (by selling the Share Options against the payment of a price corresponding to TMSC's value). This shows that Canon did not get 'genuine' options, which would give it the right (i.e., the possibility) to buy TMSC at a later stage (by paying the price at the time of the exercise of the options)",* §140.

31 In the same sense, *Commission Consolidated Jurisdictional Notice, ibid,* states that *"(60) An option to purchase or convert shares cannot in itself confer sole control unless the option will be exercised in the near future according to legally binding agreements.* (…)".