EU COURT OF JUSTICE CLARIFIES THE EU MERGER REGULATION PROHIBITION ON GUN JUMPING?

In its judgment in *Ernst & Young,* the Court of Justice of the EU (**CJEU**) provided guidance on the scope of the prohibition on implementing a transaction that is notifiable under the EU Merger Regulation (**EUMR**) prior to its clearance by the European Commission (so-called "gun jumping"). The judgment is a first piece in the puzzle of what amounts to gun-jumping under the EUMR, but leaves open important issues that are expected to be addressed by other, ongoing cases. In the meantime, broad reliance on the judgment may be limited by the unusual facts of the case.

Key issues

- Where a transaction is notifiable under the EU Merger Regulation, what preparatory steps can the parties take prior to clearance by the European Commission?
- What are the wider implications of the Court's judgment for "warehousing" transaction structures and pre-closing conduct clauses in sale and purchase agreements?

AN UNTIMELY TERMINATION?

KPMG Denmark (the **Target**) was party to a a cooperation arrangement with KPMG International, the terms of which prevented the Target from entering into other commercial contracts, such as partnerships and joint ventures. Therefore, when the Target entered into a merger agreement with Ernst & Young (**E&Y**) – a transaction that was notifiable under Danish merger control rules - it had to terminate the KPMG International cooperation agreement.

Since the Target gave notice to terminate the cooperation agreement before the Danish competition authority had cleared the merger, the authority considered that this constituted illegal gun jumping. It duly referred E&Y to the Danish State Prosecutor for Serious Economic and International Crime with a view to assessing whether criminal penalties should be imposed.

Following an appeal by E&Y of the authority's decision, the Danish court referred a number of questions to the CJEU on the scope of the standstill obligation under the EUMR. As the Danish merger control rules are expressly based on the EUMR, the CJEU accepted that it had jurisdiction to answer those questions.

A TIMELY CLARIFICATION?

In its judgment of 31 May 2018, the CJEU held as follows:

- The prohibition on gun jumping applies only to steps which "in whole or in part, in fact or in law, contribute to the change in control of the target undertaking".
- While inter-dependent transactions might be considered to form part of one and the same notifiable merger, they will not, individually, breach the

prohibition on gun jumping unless they are "necessary" to achieve the change of control. Other interim steps fall outside the scope of the prohibition, as they do not present "a direct, functional link" with the implementation of the concentration.

- It is irrelevant whether an interim step had any effect on the market or on the structure of competition. It was therefore of no significance that some of the Target's customers had responded to the notice of termination by switching their custom to KPMG International or other competitors.
- Applying that test to the facts of the case, the Target's notice of termination did not contribute to the change of control of the Target and therefore did not amount to gun jumping. That was true even though withdrawal from the cooperation with KPMG International was a pre-condition of the merger with E&Y. In particular, E&Y had not acquired the possibility of exercising any influence on the Target as a result of the termination, and the termination was a transaction between the Target and a party (KPMG International) that was not involved in the merger.

JUST ONE PIECE OF THE PUZZLE

This is the first judgment of the EU Courts to offer guidance on what pre-closing steps may be considered to breach the gun jumping prohibition. However, it leaves open some important questions.

Parking permitted?

One of the open questions is whether the judgment re-opens the door to warehousing structures (otherwise known as "parking" or "two step" arrangements) whereby the target is transferred to one or more third parties as an interim step, prior to competition clearance, before being transferred to the ultimate purchaser once clearance has been obtained. Such structures are valuable transactional tools: they facilitate the efficient allocation of risk between seller and purchaser, and so allow transactions to take place that would not otherwise be possible. However, the European Commission's current view is that the interim step in a warehousing arrangement may amount to gun jumping.

On one reading of the judgment, interim steps that do not directly contribute to an acquisition of control by the ultimate purchaser can be implemented lawfully, even if they entail a transfer of control to third parties or a loss of control by the seller. If this is correct, the Commission would need to revisit its view.

However, another reading of the judgment is that it turned on facts that might limit its wider applicability to warehousing arrangements. In particular, the CJEU emphasised that, due to the nature of its cooperation agreement with KPMG International, the Target was an autonomous and independent undertaking even before the cooperation agreement was terminated, and remained so until the date that it closed its merger with E&Y. Accordingly, the termination could not be said to lead to a change in the control of the target. If that was a decisive factor in the Court's ruling, the result could be different if – as will usually be the case – the target is under the control of a seller prior to the implementation of the interim step, and that step results in the seller ceasing to have control.

In other words, the judgment leaves it unclear whether it is only steps that involve the acquisition of control by the buyer which amount to gun jumping, or whether any related change in the control structure of the target might also be

caught. If it is the latter, the implications of the judgment may be confined to the rather unusual facts of the merger between the Target and E&Y.

Pre-closing conduct clauses

Another open question is what the judgment means for clauses in contracts for the sale and purchase of a business that relate to the pre-closing conduct of the target. It is well established that contractual provisions providing the purchaser with the ability to exercise "decisive influence" over a target's strategic commercial conduct during the pre-closing period may be viewed as conferring control and therefore breaching the gun jumping prohibition.

The Court did not assess whether the contractual obligation imposed on the Target to terminate its agreement with KPMG International immediately after the signing of the merger agreement could, in itself, be considered an exercise of decisive influence by E&Y. Consequently, even if it is assumed that the CJEU implicitly accepted that contractual control over the termination of the Target's cooperation agreement did not amount to implementation of a general power of control, it is unclear whether that reasoning extends to other types of decision and, if so, which ones. In particular, control over decisions more closely related to a target's day-to-day competitive conduct – such as decisions on production capacity, staffing levels or pricing – might be more likely to be viewed as having a direct, functional link with the transfer of control over a target.

In addition, the CJEU stressed that even if pre-closing conduct falls outside the scope of the gun-jumping prohibition, it may be subject to the prohibition on anticompetitive agreements contained in Article 101 of the Treaty on the Functioning of the EU, such that any such conduct that involves anti-competitive coordination between competing parties prior to closing will still be prohibited.

CONCLUSION

The E&Y judgment is a piece in the puzzle of what amounts to gun jumping under the EUMR, but that puzzle remains incomplete in some important respects. Fortunately, the decades-long wait for judicial guidance on gun jumping has not ended with a single, isolated case. There are two more ongoing cases, one relating to warehousing arrangements, that is soon to be appealed to the General Court and another, relating to pre-closing conduct clauses, that is under investigation by the European Commission. It is expected that these cases should address some of the outstanding issues.

Pending the outcome of those cases, reliance on the E&Y judgment to agree more extensive preparatory steps during the period prior to merger control clearance will continue to carry gun jumping risks.

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