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EUROPEAN COMMISSION REAFFIRMS PROHIBITION ON WAREHOUSING STRUCTURES UNDER THE EUMR

The European Commission has fined Canon €28 million for partially implementing its acquisition of Toshiba Medical Systems Corporation (**TMSC**) before having obtained clearance under the EU Merger Regulation (**EUMR**). The transaction had been structured as a two-stage "warehousing" arrangement, in which an interim buyer acquired control of TMSC before EUMR approval had been obtained, followed by a transfer of ownership to Canon after EUMR approval.

The Commission's decision to fine Canon for gun-jumping reaffirms its long-standing position that such warehousing structures breach the EUMR prohibition on implementation of a notifiable transaction prior to clearance. However, it remains to be seen whether the EU Courts agree with that position.

Key issues

- What are warehousing structures and why are they used?
- Do they breach the prohibition on implementing a transaction prior to clearance under the EU Merger Regulation?
- What alternative contractual structures and mechanisms can be used to shift antitrust risk in M&A transactions?

WAREHOUSING WOES

In March 2016, Toshiba entered into an agreement to sell its medical systems business to Canon. Due to financial difficulties, Toshiba needed the purchase price quickly and faced a timeframe that would make it difficult, if not impossible, to file premerger notifications and receive the necessary clearances in several jurisdictions.

The transaction structure involved two stages:

- First, the voting shares in the target were transferred to the ownership of an interim buyer - MS Holding Corporation (**MSHC**) - for a nominal payment of €800. MSHC was a special purpose company that was created at the direction of Canon and Toshiba for the purposes of the transaction, with three individuals as shareholders: a lawyer, an accountant and a businessman. At the same time, Canon paid the full €5.28 billion purchase price in return for warrants that were convertible into voting shares in the target, as well as a non-voting share in the target that gave it veto rights over any decision to sell the target to any other purchaser. This "warehousing" step was implemented before the transaction was notified to, or cleared by, various competition authorities, including the European Commission.

- The second step, which was not implemented until after clearance, involved Canon converting the warrants into voting shares for a nominal price of JPY 100 (less than €1) and so acquiring full control of the target.

While the Commission cleared the transaction in September 2016, it has now concluded that the warehousing stage of the transaction was put into effect in breach of the prohibition on implementing a notifiable transaction prior to clearance (often referred to as a "gun-jumping" infringement).

Up until 2007, the Commission allowed warehousing arrangements of this type (notably in Lagardère's 2002 acquisition of Vivendi Universal Publishing). However, its Consolidated Jurisdictional Notice announced a change in that position, explaining that where an interim buyer acquires shares on behalf of the ultimate acquirer, the Commission will treat the interim warehousing transaction as the first step of a single concentration comprising the acquisition of control by the ultimate buyer. Consequently, implementation of that warehousing stage will amount to a gun-jumping breach, in the eyes of the Commission, even if it does not itself confer control over the target.

The Commission's approach to warehousing arrangements has been adopted by a number of other antitrust agencies. Indeed the parties to the Canon/TSMC transaction also received fines or warnings for gun-jumping in China, Japan and the US.

STRUCTURAL SOLUTIONS

Warehousing structures allow for a quick sale and shift to the buyer all risks in respect of any merger clearance processes. However, the risk of gun jumping fines means that merging parties should consider other mechanisms to achieve their aims when required to file in a jurisdiction that follows the same approach as the Commission. In particular, where there is a pressing need to implement a transaction swiftly – e.g. due to financial difficulties of the target or the seller – most merger control regimes (including the EUMR) allow the parties to apply for a derogation to the prohibition on early implementation. Where the concern instead is to ensure that the seller is exposed to minimum antitrust risk in respect of the merger clearance process, various contractual structures and risk-shifting mechanisms can be considered, such as:

- "hell or high water" obligations, requiring the buyer to offer whatever remedies are required to secure clearance;
- "take or pay" provisions, requiring the buyer to pay the full purchase price in the event that the transaction is prohibited, with the seller agreeing to find an alternative purchaser and to reimburse the proceeds of that sale to the thwarted buyer;
- "backstop" arrangements, in which a third party commits to buy the target in the event that the sale to the intended purchaser is blocked; and
- "shifting alliances" structures, in which a consortium purchaser is structured so that no individual consortium member is able to exercise control over the target, with the result that no mandatory filings are triggered.

AN APPEALING APPEAL?

Canon has stated that it will appeal the fine, and there are some precedents which suggest that the EU Courts might take a different approach than the Commission to warehousing arrangements. In its 2010 *Editions Odile Jacob* judgment, the EU General Court found that a similar warehousing arrangement – albeit with a fully independent bank acting as the warehouser - had not resulted in any acquisition of control by the ultimate purchaser during the warehousing period. The more recent *Ernst & Young* judgment of the EU Court of Justice held that an ancillary or preparatory pre-closing step will not be considered to implement a transaction in breach of the prohibition, unless it "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.

Clearly, the acquisition of TMSC by the interim buyer brought about a change in control of the target, but can it be said to have contributed to the acquisition of control by Canon, if Canon was not able to exercise control during the warehousing period? Canon has stated that it considers the warehousing step to have been preparatory and consistent with the *Ernst & Young* judgment, while the Commission's press release asserts that, on the contrary, the warehousing "was necessary for Canon to gain control over TMSC". The EU General Court will decide who is right when it rules on the matter in a few years' time.

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