

EU GENERAL COURT UPHOLDS CANON'S GUN JUMPING FINE FOR “WAREHOUSING” TRANSACTION

The General Court of the EU has upheld the €28 million fine imposed by the European Commission against Canon in 2019 for partially implementing its acquisition of Toshiba Medical Systems Corporation (**TMSC**) prior to receiving clearance under the EU Merger Regulation (**EUMR**).

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, or to obtain derogations from the applicable standstill obligations.

The transaction structure involved two stages:

- The first step (March 2016): the warehousing stage. 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 (December 2016): this was not implemented until after clearance and 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.

At the same time, prompted by an anonymous complainant, the Commission opened an investigation in July 2016 to determine whether this breached the EUMR prohibition on implementing a notifiable transaction prior to clearance (the "standstill obligation") and subsequently imposed a fine of €28 million in 2019. Shortly thereafter, Canon appealed the Commission's decision before the General Court.

Key issues

- Does a breach of the EUMR standstill obligation require that control is acquired in full or in part?
- Where is the line between permissible "preparatory" steps and those which contribute to a change of control?
- How does *Canon/Toshiba* differ from the *Ernst & Young* case?
- What other mechanisms can be used to shift merger control

General Court's findings

Contribution to change of control

Canon argued that the completion of the warehousing stage, before the Commission's clearance of the whole transaction, did not lead to a change of control over TMSC and, as such, could not be considered to implement the Canon's acquisition of TMSC in breach of the standstill obligation.

Both Canon and the Commission relied on differing interpretations of the EU Court of Justice's 2018 judgment in *Ernst & Young*, which found that an ancillary or preparatory pre-closing step would 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. Canon argued that the warehousing step was preparatory, while the Commission asserted that, on the contrary, it "was necessary for Canon to gain control over TMSC". In its May 2022 judgment, the General Court sided with the Commission, confirming that the implementation of a concentration is not limited to the acquisition of control, but can also cover any operations which contribute to a lasting change of control of the target. The General Court found that:

- without the two-step warehousing transaction structure proposed by Canon, Toshiba would have been unable to renounce its control of TMSC and irreversibly collect payment from Canon before the end of March 2016, as Toshiba would have had to wait for clearance from the competition authorities to sell TMSC;
- under the two-step warehousing structure, the first step was a necessary step to achieve a change of control of TMSC; and
- the warehousing stage therefore had a "direct functional link" with the change of control over TMSC and was not ancillary or preparatory to it.

Distinct legal transactions can be of unitary nature

The General Court, following previous case law, found that distinct legal transactions can constitute a single notifiable concentration if they have a unitary character and, in particular, if they are interdependent in such a way that one transaction would not have been carried out without the other. It concluded that both steps of Canon's warehousing arrangement met this test, as the first step was carried out only in view of the entire transaction, and MSHC was created solely for the purposes of facilitating Canon's acquisition of control over TMSC. In addition, Canon had acquired the possibility of exercising a certain degree of influence (albeit not control) over TMSC from the date of the first stage, irrespective of the outcome of the merger clearance, by acquiring the possibility to determine the identity of TMSC's ultimate purchaser and by assuming the economic risk of the entire transaction.

Acquisition or implementation?

The General Court noted that the concept of "implementation" of a notifiable transaction is distinct from the concept of the "acquisition of control" to which a transaction eventually leads. Implementation of a transaction may occur gradually over a period of time, through partial implementation of a single overall transaction, whereas control is acquired at a single point in time, when the acquirer has the ability to exercise decisive influence over the target company.

Why was the *Ernst & Young* case different?

In *Ernst & Young* (E&Y), the General Court found that E&Y had not infringed the equivalent standstill obligation under the Danish merger rules when it agreed with the target that it would terminate its cooperation agreement with another accounting firm prior to its acquisition by E&Y, and before obtaining clearance from the Danish competition authority. Despite the fact that E&Y's acquisition would have amounted to a contractual breach of that cooperation agreement had it not been terminated, and that termination was also a contractual pre-condition of E&Y's acquisition agreement, the General Court found that the termination was not necessary to achieve E&Y's acquisition of control, and did not contribute to it.

Why, then, was Canon's warehousing step considered necessary for its acquisition of control of TSMC, when the contractually-required termination of a third party agreement was not in E&Y? In its *Canon* judgment, the General Court explained that the difference lay in the fact that the termination in E&Y was a unilateral transaction with no consideration that did not confer on E&Y any possibility of exercising control over the target and did not itself result in any change in the independence of the target. In contrast, the warehousing step of Canon's transaction contributed to Canon's ultimate acquisition of control by conferring on Canon the possibility to exercise a certain influence over the target in the interim period (obtaining the sole power to determine the identity of any alternative purchaser of TSMC) and by resulting in Toshiba ceasing to have control over TSMC, in exchange for an irrevocable payment of €5.28 billion.

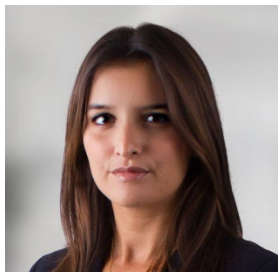
Key takeaways

The General Court's judgment sheds only limited new light on where to draw the line between permissible "preparatory" steps and those which contribute to a change of control. It does, however, confirm the Commission's long-standing position that warehousing arrangements cannot be used to circumvent the EUMR's standstill obligation.

The General Court's emphasis on certain facts – such as Canon's role in the creation of MSHC and its right of veto over any sale of TSMC to another buyer – could be read as implying that a different warehousing structure might have been acceptable. However, reliance on such an interpretation would be extremely risky, not least because the Commission continues to maintain that warehousing arrangements infringe the standstill obligation irrespective of the status or independence of the interim buyer. And now that the General Court has approved the Commission's first ever fine for a warehousing structure, it may be expected that fines for any future use of such a structure would be even higher than Canon's.

There are some alternative transaction structures that can (depending on the jurisdictions in which clearances are required) give a seller the certainty of receiving the purchase price even if a transaction is blocked by a competition authority. However, for deals like *Canon/Toshiba* where payment and transfer of the target must be implemented in a timeframe that is too short to obtain EUMR clearance, or even a derogation from the standstill obligation, buyers would need to factor into their purchase price the likelihood of substantial fines or, better still, walk away.

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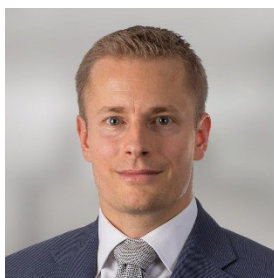
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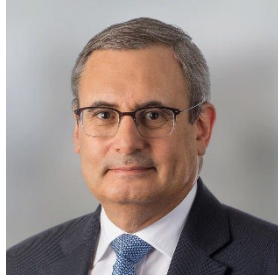
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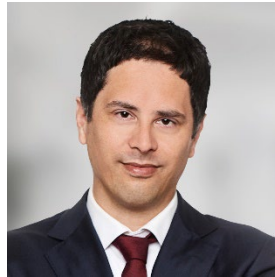
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