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The *Canon/Toshiba* case: A shot across the bow on warehousing

On 6 July 2017, the European Commission issued a Statement of Objections against Canon, alleging a “gun-jumping” infringement of the EU Merger Regulation. The alleged infringement stemmed from the two-step “warehousing” deal structure used in Canon’s acquisition of Toshiba Medical Systems Corporation.¹

The European Commission’s (“EC”) preliminary findings against Canon form part of an unprecedented surge in enforcement activity directed at alleged violations of the procedural merger control rules. On the same day, the EC adopted two further Statements of Objections (“SO”): against General Electric and Merck KGaA for the supply of incorrect or misleading information under the EU Merger Regulation (“EUMR”).² Commissioner Vestager tweeted in the early morning hours of 6 July:

“3xStatements of Objections in 3 separate cases: Not giving full/accurate information or putting a merger into effect before cleared. Don’t”

Less than two months earlier, the EC fined Facebook €110 million for “at least negligently” providing misleading information in a merger case,³ and also opened a gun-jumping investigation against Altice.⁴ EU Member State authorities have recently taken action in several such cases.⁵ If there was ever any doubt, this wave of proceedings confirms that procedural merger control rules must also be fully respected.

The EC has yet to adopt a final decision in the *Canon*-case, but Chinese and Japanese authorities confirmed that the very same deal structure fell afoul of

¹ The press release is available here http://europa.eu/rapid/press-release_STATEMENT-17-1929_en.htm

² Commission IP/17/1924 (6 July 2017), available here http://europa.eu/rapid/press-release_IP-17-1924_en.htm

³ Commission IP/17/1369 (18 May 2017), available here http://europa.eu/rapid/press-release_IP-17-1369_fr.htm

⁴ Commission IP/17/1368 (18 May 2017), available here http://europa.eu/rapid/press-release_IP-17-1368_en.htm

⁵ The French Competition Authority fined Altice €80 million for gun jumping. Information can be found here http://www.autoritedelaconcurrence.fr/user/standard.php?id_rub=630&id_article=2900&lang=en; a question (C-633/16) has recently been referred by the Danish courts to the Court of Justice of the European Union seeking to clarify, in the context of merger proceedings between KPMG Denmark and Ernst & Young, the legality of an announcement by KPMG Denmark of the proposed termination of a cooperation agreement with KPMG International as part of the merger with Ernst & Young.

the merger rules in those countries. As explained below, the *Canon*-case suggests that warehousing structures can constitute a gun jumping risk, even if the ultimate buyer does not exercise control over the target prior to antitrust clearance.⁶

Background

A fundamental pillar of EU Merger Control is the standstill obligation contained in Article 7(1) EUMR, which prohibits the parties from implementing transactions prior to formal clearance. Early implementation of a transaction (also known as gun-jumping) can lead to fines of up to 10% of the group turnover of the party (or parties) acquiring control.

In competitive auctions, the standstill obligation often places strategic bidders at a disadvantage. They may be prepared to place high bids, compared to non-strategic bidders, but often face more protracted merger approval processes.

Warehousing (or “parking”) deal structures have occasionally been employed in this context to resolve this disadvantage for strategic bidders and place them on an equal footing with other bidders. Under these arrangements the target business is first acquired by an interim buyer, typically a bank, which has a back-to-back arrangement with the ultimate purchaser, who acquires the target after receipt of the necessary antitrust clearances.

The Canon/TMSC warehousing structure

Under the transaction agreements among Toshiba, Canon and a special purpose vehicle (“SPV”), Canon’s acquisition of Toshiba Medical Systems Corporation (“TMSC”) would take place in two steps:

- > First, at **Step 1**, the SPV, created by three individuals (unaffiliated to either Toshiba and Canon), paid Toshiba €800 for 20 Class-A shares (representing 95% of the shares) of TMSC. Canon paid Toshiba €2.58 billion for one Class-B share (representing 5% of the shares) of TMSC) *plus* 100 warrants to acquire the SPV’s stake. This step took effect when the three parties signed the transaction agreements, before any antitrust clearances had been obtained. In effect, Canon paid Toshiba the full purchase price prior to obtaining the antitrust approvals.
- > Second, at **Step 2**, Canon acquired full ownership of TMSC by converting the 100 warrants into shares. This step took effect after EUMR and other necessary antitrust clearances were obtained. TSMC subsequently bought back the Class-A and Class-B shares from the SPV, and Canon cancelled these shares.

Canon notified the entire arrangement to the EC on 12 August 2016, noting that Canon will only be able to convert the warrants into shares once it obtains all the necessary antitrust approvals.⁷ While the EC unconditionally cleared the

⁶ The previous *Electrabel* (IP/09/895, C-84/13 P) and *Marine Harvest* (IP/14/862, T-704/14) cases involved the exercise of *de facto* control, while the pending *Altice* case involves the exercise of *de jure* control, prior to EUMR clearance.

⁷ See case M.8006 - *Canon/Toshiba Medical Systems Corporation* (19 September 2016), para. 8.

deal on 19 September 2016, in its subsequent SO issued on 6 July 2017, the EC took the position that this structure constitutes partial “implementation” of the transaction prior to merger clearance. The Commission is not considering withdrawing its clearance decision, but it is considering imposing a gun jumping fine on Canon.

What does this mean for warehousing arrangements and two step option structures going forward?

The *Canon*-case is a shot across the bow regarding the use of two-stage option warehousing structures. As explained below, the Commission has previously objected to warehousing structures. The additional feature which appears to have raised gun jumping concerns in this case is the upfront payment of consideration in Step 1. Many are following the case with interest.

The EC is not the only authority that objected to this particular deal structure. China’s MOFCOM⁸ and Japan’s FTC⁹ both issued decisions condemning the structure, with MOFCOM also imposing a modest fine of €40,000. MOFCOM explained most clearly that the two transaction steps formed part of one single concentration, and that the immediate implementation of the first step, prior to merger clearance, amounted to gun-jumping. The EC appears to have reached the same preliminary conclusion, although the fine risk under the EUMR is considerably higher: up to 10% of Canon’s worldwide turnover.

Prior to 2008, warehousing structures were employed more widely, and there was at least one instance where the EC found that such an arrangement was exempted from notification since it involved a temporary acquisition by a financial institution.¹⁰ This position was upheld by the Court of First Instance (now General Court).¹¹

However, in the Consolidated Jurisdictional Notice adopted in 2008, the EC announced a major shift in its stance towards warehousing arrangements: structures involving an interim buyer acquiring a target business on behalf of an ultimate acquirer will be viewed as the “first step of a single concentration”. This effectively means that warehousing structures would be liable to constitute gun jumping violations even if they do not confer control rights to the ultimate buyer during the interim period.¹²

As a result, Parties have typically been cautious in pursuing warehousing structures since the amendments to the CJN in 2008.

A number of cases have employed so called “reverse” warehousing, where the bank or third party is the default purchaser of the target in the event a long stop date is hit without clearance. Such structures in principle do not raise the same

⁸ On 4 January 2017, after a gun-jumping investigation prompted by an informant, MOFCOM imposed its first ever gun jumping fine on a non-Chinese company: RMB 300,000 (with the maximum being RMB 500,000 – approximately €60,000).

⁹ On 30 June 2016, the JFTC cleared the acquisition, but at the same time issued a “caution” to Canon not to use a similar structure in the future, on the basis that it is capable of breaching the prior notification obligation imposed under Japan’s merger control law.

¹⁰ See case *M.2978, Lagardere/Natexis/VUP* (7 January 2004), paras. 6-7.

¹¹ See case *T-279/04, Editions Odile Jacob SAS vs. European Commission*, paras. 116-163.

¹² See Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (2008/C95/01), para. 35.

concerns around the viability of the target business during the interim period in the way previous warehousing structures have. Other hybrid structures have been pursued only following discussions with the Commission.

The Canon case underlines the need for caution in employing two step structures given the risk of the Commission looking through these and treating the transaction as one overarching concentration.

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