

# The ECJ provides welcome guidance on the stand-still obligation in mergers

## Kluwer Competition Law Blog

June 5, 2018

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*Please refer to this post as: Thomas Wilson, 'The ECJ provides welcome guidance on the stand-still obligation in mergers', Kluwer Competition Law Blog, June 5 2018,*

*<http://competitionlawblog.kluwercompetitionlaw.com/2018/06/05/ecj-provides-welcome-guidance-stand-still-obligation-mergers/>*

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### Speed read

On 31 May 2018, the EU's Court of Justice (**ECJ**) gave judgment in the *EY / KPMG* case on whether the EU suspension obligation was violated when KPMG's Danish unit terminated a material contract prior to receiving competition clearance for its merger with Ernst & Young (**EY**).

The ECJ concluded that the measure did not constitute a partial implementation of the transaction and therefore did not infringe gun-jumping rules. The ECJ clarified that the suspension obligation only applies to actions of the merging parties which **"in whole or in part, in fact or in law, contribute to the change in control of the target undertaking"**. The ECJ has thus rejected and cut back the much wider understanding of the suspension obligation advocated by the European Commission (the **Commission**), which acted as an intervener in the case. Where the Commission supported a broad and general 'stand-still obligation' in the pre-clearance phase, the ECJ has limited the suspension obligation to actions directly related to bringing about a change of control over the target company. The ECJ however highlighted that pre-merger coordination outside the scope of the suspension obligation may be prohibited by the EU rules against restrictive agreements in Article 101 of the Treaty on the Functioning of the European Union

**(TFEU).**

While the judgment provides some welcome clarifications in relation to the concept of gun-jumping, which is traditionally viewed as a legal 'grey zone', it is premature to tell to which extent the judgment will in practice allow farther reaching pre-closing interactions than in the past:

- First, the notion of pre-closing actions 'contributing in whole or in part, in fact or in law, to the change in control' remains vague, leaving scope for interpretation. It is possible that the Commission may choose to interpret the concept widely to limit any changes from its current practice, not least since it has only recently imposed a high fine on Altice for alleged multiple infringements of the suspension obligation - in a decision which will be appealed by the defendant and which the Commission will want to defend in court.
- Second, any actions which fall outside the scope of the gun-jumping prohibition can still remain caught by the prohibition on restrictive agreements, to the extent that they result in a restriction of competition.

Overall, however, it appears that the judgment will provide **more scope for certain pre-clearance measures which cannot be seen as contributing to a change of control** over the target business.

In transactions notifiable at the national level, the merging parties will however have to keep in mind that some national courts have attributed a wider scope to the suspension obligation than does the ECJ.

## **Background**

The Commission and many other authorities operate 'suspensory' merger control regimes, which impose strict prohibitions on parties taking any steps which could be construed as early integration. Any involvement by a buyer in a target's business before a deal is cleared risks heavy financial penalties.

In recent years, the Commission and other competition authorities across the globe have become increasingly strident in pursuing breaches of gun-jumping rules:

- In 2016, the French competition authority fined Altice €80m for various

joint planning measures implemented prior to closing of its acquisitions of SFR and OTL.

- In 2017, the Commission issued a statement of objections to Canon for the use of a 'warehousing' structure for its acquisition of Toshiba's medical equipment unit (following a fine of ca. €39,000 by China's MOFCOM).
- In April 2018, only a month ago, the Commission fined Altice €124.5m for obtaining certain veto rights over PT Portugal's ordinary business, giving instructions on marketing campaigns and receiving competitively sensitive information outside the framework of any confidentiality agreement prior to closing of its acquisition of PT Portugal.

The *EY / KPMG* case represents another example of this trend.

### **The EY / KPMG case**

In November 2013, KPMG Denmark (***KPMG DK***) entered into a merger agreement with EY (the ***Merger Agreement***). The proposed transaction was subject to approval from the Danish Competition and Consumer Authority (***DCCA***). Under the Merger Agreement, KPMG DK was to terminate its cooperation agreement with KPMG's international network (***KPMG International***) which, amongst other things, gave KPMG DK the exclusive right to be included in KPMG International in Denmark and allowed KPMG to use the KPMG trademark. KPMG DK's notice of termination was irreversible as neither EY nor KPMG DK could – either unilaterally or collectively – rescind it. Following the announcement of the transaction, KPMG International established a new auditing business in Denmark (as a result of which several of KPMG DK's clients decided to change auditors). The DCCA cleared the proposed transaction in May 2014. In December 2014 it issued a decision finding that the pre-clearance termination notice given by KPMG DK amounted to a premature implementation of the EY / KPMG DK transaction. In June 2015, EY appealed the DCCA's decision before the Danish Maritime and Commercial Court, which referred the case to the ECJ for a preliminary ruling on the scope of the EUMR suspension obligation (the Danish gun-jumping rule is essentially modelled after the EUMR provision).

### **The gun-jumping criteria applied by the DCCA**

The DCCA found that:

- the measure in question was irreversible (as the notice of termination could not be rescinded);
- the behaviour was merger-specific as KPMG DK would not have served the notice of termination absent the merger; and
- KPMG DK's notice of termination had an inherent potential for market effects as the future of KPMG DK as a Danish audit firm outside of KPMG's international network would have been uncertain if the merger were to be blocked.

The Commission sided with the DCCA at the oral hearing before the ECJ.

### **The position taken by the ECJ**

The ECJ held that serving notice to terminate the cooperation agreement did not constitute 'gun-jumping' under Article 7(1) EUMR. The ECJ defined the benchmark for assessing whether a measure amounts to gun-jumping as follows: '**A concentration is only implemented by a transaction which, in whole or in part, in fact or in law, contributes to the change of control of the target undertaking**'.

The ECJ ruled that KPMG DK's withdrawal from the cooperation agreement with KPMG International did not meet this test. In the words of the ECJ: '*even though that withdrawal is subject to a conditional link with the cooperation in question and is likely to be of **ancillary and preparatory nature**, the fact remains that, despite the effects it is likely to have on the market, it does not contribute, as such, to the change of control of the target undertaking*'. Rather, there needs to be a '**direct functional link**' with the implementation of the transaction. Transactions that are not '**necessary**' to achieve a change of control do not fall within the scope of the suspension obligation, even if they are carried out in the context of a concentration. The occurrence of market effects (or the lack thereof) is not a suitable criterion by itself to determine whether a measure falls within the scope of the suspension obligation. Therefore, the fact that the termination notice had already significantly impacted the market structure (with EY setting up a new business in Denmark and customers switching) did not affect the finding that there was no gun-jumping.

## The implications for merging parties

The Commission had argued before the ECJ that a partial implementation of a merger may, *inter alia*, arise in respect of measures which '(i) consist of preparatory steps in the course of a procedure leading to a change of control; or (ii) allow the party obtaining control to gain influence over the structure or market behaviour of the target undertaking; or (iii) otherwise pre-empt the effects of the merger or significantly affect the prevailing competitive situation'. In contrast, the judgment limits the scope of Article 7 EUMR by tying it back to the EUMR concept of a concentration. Any pre-merger coordination between the parties not falling under the stand-still obligation can, however, still be caught by Article 101 TFEU. The ECJ confirms that the suspension obligation and Article 101 TFEU do not apply in parallel, but that Article 101 applies to such pre-merger coordination which is not caught by the suspension obligation. Unlike Article 7 EUMR, Article 101 requires the relevant conduct to constitute a restriction of competition, which adds an additional element that competition authorities would need to prove for an infringement. Another difference is that only the purchaser and the target can be fined for violations of the EUMR suspension obligation; fines for a violation of Article 101 TFEU can also be imposed on the seller.

While the 'contributing to the change of control' test applied by the ECJ remains vague, it still appears to **provide a broader freedom for the merging parties to take such pre-merger preparatory measures** which are clearly unrelated to any change of control. This may, *inter alia*, include:

- **purely unilateral measures** by the target taken with a view to the upcoming merger, even if there are certain market effects; or
- **pre-merger coordination which neither contributes to a change of control nor can be seen as restricting competition** (pre-merger coordination in cases where the parties are not competitors or where they compete but the concrete measures envisaged have no effect on competition).
- Similarly, while **exchange of information** in the context of due diligence will remain subject to Article 101 TFEU, it should **fall outside of the scope of the suspension obligation** (this may be particularly relevant for information exchange between non-competitors).

On the other hand, it is clear that any measures which give the purchaser legal or factual means to influence the target's operations before clearance continue to be caught by the suspension obligation. This would for example be the case if:

- the purchaser acquired **influence over the appointment of members** to the target company's board prior to closing; or
- the **purchase agreement conferred decision-making rights** on the purchaser, allowing it to influence the ordinary course of the target's business.

Between these two ends of the spectrum, there remains a broad range of measures which are more difficult to categorise under the test defined by the ECJ. Merging parties are therefore well advised to continue to be cautious and carefully monitor the further development of enforcement practice in this respect.

For further reading please see the following links:

- the ECJ's judgment: <http://curia.europa.eu/juris/document/document.jsf?text=&docid=202404&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=159043>
- my Kluwer blog entry on the AG Wahl's opinion in this case: <http://competitionlawblog.kluwercompetitionlaw.com/2018/01/19/ag-wahl-eykpmg-latest-gun-jumping/>

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The above is a joint contribution from Thomas Wessely, Sascha Schubert, Alastair Chapman, Thomas Wilson and Thomas McGrath.