Kluwer Competition Law Blog

'Gun-jumping' in voluntary merger regimes: The risks keeping global transactions in suspense

Chris Boyd (Kirkland & Ellis LLP) · Thursday, October 24th, 2019

Much has been written of the heightened risk of gun-jumping enforcement by competition regulators overseeing mandatory suspensory merger regimes. This article will examine why merger parties and their advisers must also be alive to 'gun-jumping' risks in jurisdictions where pre-merger notification is voluntary and there are no automatic standstill obligations.

Alongside the succession of 'gun-jumping' cases in the UK during the past year, including the record fine against PayPal (£250,000) for failing to comply with an interim enforcement order, the Australian **Cryosite Case** underscores the need for merger parties to remain as independent competitors until closing. The consequences of failing to do so can be the breach of competition rules, with large penalties (over $1 million in this case) and the opprobrium of a cartel finding for contraveners.

'Jumping the gun' in a voluntary merger regime

Within the OECD, **Australia**, **New Zealand** and the **UK** are the three jurisdictions operating purely voluntary merger control regimes. As explained in a recent European Union (**EU**) paper on the subject,[1] the competition authorities in these jurisdictions possess broad mandates to review any merger or acquisition regardless of whether it has been notified, and irrespective of whether or not it has been consummated. Those authorities – the Australian Competition and Consumer Commission (**ACCC**), the New Zealand Commerce Commission (**NZCC**) and the UK Competition and Markets Authority (**CMA**) – have a history of proactive and effective enforcement of their respective merger and anti-competitive conduct rules.

Unlike in the EU, where Article 7 of the EU Merger Regulation (**EUMR**) imposes a standstill obligation on parties to notifiable transactions subject to clearance by the European Commission (**Commission**), in these voluntary jurisdictions there are no default suspensory requirements or sanctions for closing ahead of receipt of merger clearance.

Nonetheless, clear regulatory and legal risks remain (generally described as 'gun-jumping' risks), and may be broadly categorised as follows:

1. Violation of merger specific interim measures put in place by a competition authority to interrupt ongoing integration or prevent further co-operation or implementation of a merger; and / or

2. Contravention of general domestic laws aimed at preventing cartel conduct (i.e., market or customer allocation, or agreements on price, terms of business or future strategy between competitors) or other anti-competitive practices (e.g., exchange of competitively sensitive information) occurring prior to completion of the transaction.

Risk category 1: Violation of interim measures

Pre-closing undertakings, court ordered injunctions and interim enforcement measures are considered to be a necessary corollary to the operation of a voluntary non-suspensory merger regime by the regulators overseeing them.

- In Australia, the ACCC is empowered to request that parties to its informal clearance procedure provide written undertakings pursuant to Section 87B of the Competition and Consumer Act 2010 (Cth) (**CCA**) not to complete their transaction until its review has concluded – although this would ordinarily only be requested where the ACCC had identified *prima facie* competition concerns. If an undertaking was not forthcoming where the ACCC had such concerns, the ACCC could also seek injunctive relief from the Federal Court of Australia (**Federal Court**) to prevent completion.[2] The ACCC has the power to enforce breach of Section 87B undertakings through the Federal Court, which may result in orders to comply, fines or any other appropriate orders.
- In New Zealand, the NZCC is also empowered to prevent closing through an application for injunction to the High Court of New Zealand.
- The UK CMA oversees a unique, and from the perspective of merger parties – onerous, system of interim measures which are now routinely applied in cases of completed mergers, blocking further integration and unwinding integration that has already taken place. In anticipated mergers, where the CMA has serious concerns about pre-emptive action it has the power under Section 81 of the Enterprise Act 2002 (**Enterprise Act**) to impose an interim order that will remain in force for the remainder of its investigation. Failure to comply with an interim order (without securing an appropriate derogation from the CMA) can see merger parties subjected to fines of up to 5% of total world-wide turnover, or unwinding orders.

<u>Gun-Jumping Enforcement in the UK</u>

The UK's first 'gun-jumping' case came in June 2018, when the CMA imposed a £100,000 fine on Electro Rent for its failure to comply with the requirements of an interim order during its investigation of the completed merger of Electro Rent and Microlease. In this case, Electro Rent and its subsidiary, had terminated the lease over their only UK premises, which the CMA held to be "a flagrant breach" of the interim order, having being committed in large part by the senior management of Electro Rent. In February 2019, the UK Competition Appeal Tribunal (**CAT**) upheld the fine, declaring it appropriate "in light of the utmost importance that interim orders be scrupulously complied with." The day after the CAT's ruling, the CMA imposed an additional £200,000 fine on Electro Rent for a further breach of the same interim order (for failing to obtain its consent before appointing its CFO as a director of Microlease).

Throughout 2019, the CMA has maintained its focus on compliance with its procedural merger rules: in January the Ausurus Group was fined £300,000 for two breaches of an interim order, and in June Nichols was fined £146,000 for three breaches. In September, PayPal was hit with a record fine of £250,000 for cross-promoting the target's business (iZettle) to potential customers in the UK, in defiance of an interim order observed by a monitoring trustee during its Phase 2 investigation. The CMA considered that PayPal's conduct risked impairing the ability of iZettle and PayPal to compete independently, risked undermining the two companies' separate brand identies and meant that PayPal was not operating the customer lists of the two UK businesses separately, as required.

Risk category 2: Contravention of rules against anti-competitive conduct, pre-closing

Alongside merger specific interim measures, it is a risk for merger parties that the terms of their transaction agreement and/or pre-closing conduct contravene domestic rules against cartel conduct and other anticompetitive practices.

- Prior to closing, Australia's cartel laws prohibit parties who are are, or are likely to be, competitors from making or giving effect to a contract, arrangement or understanding between themselves (Part IV Division 1, CCA). Practices such as output restrictions, customer or market allocation or price fixing are caught by these provisions, and can lead to the imposition of civil pecuniary penalties or criminal prosecution.[3] Section 45 of the CCA also prohibits, through civil penalties, other anticompetitive arrangements that have the purpose or effect or likely effect of substantially lessening competition (which includes arrangements between non-competitors).

  In May 2019, the ACCC published a fact sheet explaining its enforcement approach to 'gun-jumping' through the cartel and anticompetitive arrangement provisions of the CCA.[4] In it, the ACCC highlights that investigations into potential gun-jumping could be expected to delay the ACCC's review of a transaction.

- Similar statutory prohibitions against cartel conduct between competitors and anticompetitive practices apply to merger parties pre-closing in New Zealand and the UK.

  In the UK, cartel conduct is regulated by the Enterprise Act and the Competition Act 1998 (**Competition Act**), while EC Council Regulation No. 1/2003 gives direct effect to the competition provisions of the TFEU, enabling the CMA to apply and enforce Article 101.

  In 2008, the NZCC commenced 'gun-jumping' proceedings before the High Court of New Zealand (**High Court**), with the High Court finding breach of the countries' cartel laws and ordering the merger parties to pay penalties totalling NZD $100,000.[5]

Of course, cartel conduct in a pre-completion merger context is also unlawful in jurisdictions host to mandatory and suspensory merger regimes. In previous infringement decisions in the United States, for example, the authorities have based their findings on both *per se* violations of Section 1 of the Sherman Antitrust Act of 1890 and Section 7A of the Hart Scott Rodino Act.[6] Although to date there has not been any equivalent Commission decisions, it is likely that similar anticompetitive practices pre-closing would represent *by object* contraventions of Article 101(1) of the TFEU.

Australia's first gun-jumping case: the Cryosite Case

The risks inherent in this second 'gun-jumping' category are demonstrated through the recent judgment of the Federal Court in the Cryosite Case (*ACCC v Cryosite Limited*), in which Cryosite Limited (**Cryosite**) was ordered to pay pecuniary penalties totalling AUD $1.05 million.[7]

In Australia's inaugural merger gun-jumping case, the Court found that the seller (Cryosite) had contravened the CCA's civil cartel prohibitions by making and giving effect to *cartel provisions* within its asset sale agreement (**ASA**). The findings represent a fundamental, though inadvertent, failure on behalf of the parties and their advisers, demonstrating the critical importance of merger parties remaining independent until completion. The case also highlights the increased risk for parties who are competitors in concentrated markets – a relevant factor here to the size of the penalty imposed. Finally, the case shows the extent to which the Australian courts and the ACCC are aligned on the importance of forcefully deterring pre-emptive coordination and integration in a merger context.

Background

On 23 June 2017, Cryosite entered into the ASA to sell its umbilical cord blood and tissue banking business to Cell Care Australia (**Cell Care**). Prior to this, Cryosite supplied, *inter alia*, services collecting, processing, storing and releasing cord blood and tissue containing stem cells (**CBT banking services**). Since March 2016, Cryosite and Cell Care had been the only two private suppliers of CBT banking services in Australia.

Upon entering into the asset sale agreement, Cell Care made a non-refundable upfront payment of AUD $500,000 to Cryosite. The asset sale agreement also included the following provisions:

- <u>Customer referral requirement:</u> During the period between signing and closing of the ASA, Cryosite committed to refer all sales enquiries in relation to its CBT banking services business to Cell Care.
- <u>Non-compete clause</u>: Cell Care committed not to seek or accept an approach from any Cryosite customer who had stored CBT with Cryosite in the five years prior to completion. The restraint applied from the date of execution, ending up to 18 months later.

As explained below, Cryosite subsequently ceased supplying CBT banking services to any customers with whom it had not already entered into a contract to supply those services.

Merger clearance was not initially sought. Rather, Cell Care had communicated to Cryosite the importance of first announcing its decision to close its CBT banking services business before announcing the proposed asset sale, as the potential for the ACCC's intervention was recognised. Ultimately, the ACCC did not reach a decision as to whether it would clear or oppose the transaction (the deal was eventually abandoned by Cell Care).

The ACCC's merger investigation and gun-jumping case

The ACCC commenced a public review of the proposed transaction in September 2017. During that review, the ACCC raised concerns that cartel conduct may have been engaged in. Consequently, the parties executed a deed of variation removing certain clauses (including the customer referral requirement).

In December 2017, the ACCC announced that it would not make a decision on whether to grant clearance under Section 50 of the CCA and would discontinue its public merger review. At the same time, the ACCC announced it was investigating the circumstances surrounding entry into the agreement and the closure of Cryosite's cord blood and tissue collection operations.

In July 2018, the ACCC instituted civil proceedings in the Federal Court against Cryosite for alleged cartel conduct. Specifically, the ACCC alleged that Cryosite entered into and gave effect to both the customer referral requirement and the non-compete clause, as well as a separate arrangement for Cell Care not to market itself to Cryosite's existing customers, in contravention of Sections 44ZZRJ and 44ZZRK of the CCA. The ACCC's case was that the purpose of these arrangements was to directly or indirectly restrict or limit the supply or likely supply of CBT banking services, or to allocate potential customers between the competing merger parties.

Judgment

Following commencement of proceedings, Cryosite reached an in-principle agreement with the ACCC to settle the case, admitting that it had breached the cartel laws through the customer referral requirement. The ACCC discontinued its other allegations.

In February 2019, Justice Beach of the Federal Court held that the customer referral requirement (a cartel provision) had been given effect to by Cryosite between 23 June 2017 until August 2017 in the following ways:

1. Cryosite ceased supplying CBT banking services to any customers with whom it had not already entered into a contact to supply those services (while retaining the ability to supply the full range of CBT services to pre-existing and new customers until at least August 2017).
2. Cryosite also established a process under which Cryosite staff would advise potential customers that Cell Care supplied CBT banking services, ask the customer if they would agree to have Cryosite send details of their enquiry to Cell Care, and if they did agree, report information about the potential customer's enquiry to Cell Care.
3. Cryosite implemented the process described above in respect of 12 enquiries received after 23 June 2017, which included sending details of four potential customers to Cell Care. Cryosite reported to Cell Care that the remaining eight potential customers preferred to contact Cell Care directly.

As to the appropriate penalty, the Court imposed pecuniary penalties totalling $1.05 million: consisting of $600,000 for making the ASA containing the impugned customer referral provision, and $450,000 for giving effect to it.

In arriving at these amounts, the Court referred directly to the need to ensure general deterrence of gun-jumping conduct:

'[A]ny penalty must be sufficient to overcome the broader incentive to businesses to prematurely coordinate or integrate their businesses ahead of the completion of a sale in a manner which has an anti-competitive purpose or effect. Such behaviour can have the commercial but illegitimate attractions of removing price or other competition between the parties, providing access to commercially sensitive information, or generating cost savings by enabling consolidation of customer bases.'[8]

As to the deliberateness with which Cryosite engaged in the cartel conduct, the Court did not suggest that it was Cryosite's intention to contravene the CCA. Rather the Court highlighted that Cryosite had retained lawyers to advise it in relation to the drafting and terms of the ASA, and that those lawyers did not raise any concerns about the cartel aspects of the customer referral provision.[9]

Other factors relevant to the Court's consideration of the appropriate penalty, included (*inter alia*):

- Cryosite and Cell Care did not seek to obtain any form of merger clearance prior to the ACCC's intervention.
- While the contravening conduct was undertaken openly in the course of business rather than covertly, it was not readily observable by parties other than Cryosite and Cell Care, and absent the ACCC's investigation would not have been detected.
- Cryosite and Cell Care were the only private suppliers of CBT banking services in Australia immediately prior to the making of the APA, and as such their coordination had a detrimental effect on the competitive process.
- Cryosite had cooperated with the ACCC, including through its admissions, agreement to the making of appropriate orders and joined in the making of submissions reflecting the seriousness of the wrongdoing.

All views expressed are the author's personal views and not necessarily those of Kirkland & Ellis.

---

[1] For further information on the EU's note on gun-jumping submitted to the OECD roundtable discussion, refer to the previous post: http://competitionlawblog.kluwercompetitionlaw.com/2019/02/25/the-eu-oecd-paper-on-gun-jumping/

[2] In respect of its formal merger authorisation process, this can only be taken advantage of by merger parties where an undertaking not to complete the transaction is entered into at the outset.

[3] The greater of AUD $10 million, three times the value of the benefits obtained or 10% of annual Australian turnover.

[4] See, ACCC, 'Gun jumping risks for merger transactions', May 2019. Available at, https://www.accc.gov.au/system/files/1565_Gun%20jumping%20fact%20sheet_FA.pdf

[5] NZCC v New Zealand Diagnostic Group and Ors HC AK CIV 2008-404-4321 [19 July 2010].

[6] See, US v Flakeboard America Limited, et al (2014), available at: https://www.justice.gov/atr/case/us-v-flakeboard-america-limited-et-al.

[7] ACCC v Cryosite Limited [2019] FCA 116 (13 February 2019). In Australia, the ACCC may investigate suspected breaches of the CCA, however only the Federal Court has the power to determine whether a contravention has occurred and, if that is the case, what penalties and other orders should be imposed. For cartel conduct, this includes both civil and criminal sanctions.

[8] Paragraph 50.

[9] Paragraph 71.

To make sure you do not miss out on regular updates from the Kluwer Competition Law Blog, please subscribe here.

This entry was posted on Thursday, October 24th, 2019 at 10:00 am and is filed under Australia, Gun jumping, New Zealand, United Kingdom, Voluntary merger regimes
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.