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RECENT GUN JUMPING ENFORCEMENT IN THE U.S., EU, AND CHINA HIGHLIGHTS NUANCED RULES

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Antitrust laws in most jurisdictions require that parties to a M&A transaction continue to act as separate and independent companies until the transaction closes. Enforcement actions by competition authorities against "gun jumping" have increased, as authorities in Europe, the United States, and Asia are more closely scrutinizing pre-clearance activities by merging parties to identify gun-jumping violations. This article reports on recent activities in the U.S., European Union, and China that reflect how authorities' experience with gun jumping has made the "rules" more nuanced.

Prohibitions on gun jumping impose two practical restrictions on merging parties. First, parties must remain separate companies prior to closing. Until the merger authority has cleared the deal or until closing, the parties cannot combine their operations or hold themselves out as a single company, and the buyer cannot begin to control the business activities of the seller. This procedural violation can result in fines, even without evidence of harm to competition. Second, parties must be careful not to share competitively sensitive information during due diligence in a way that might lessen competition between them either pre-closing or if the transaction does not close. Exchanging competitively sensitive information, such as current or future prices, strategic plans, individual customer or supplier details, or sensitive cost information, may implicate antitrust rules if it allows the competing parties to raise prices or otherwise lessen competition.

United States

The U.S. has notification and waiting-period requirements for mergers that exceed certain thresholds. During the waiting period, the merging parties are prohibited from completing the transaction, and any gun jumping

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violations are subject to enforcement actions under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act"). In addition, until closing merger parties also remain subject to liability under Sherman Act § 1, which prohibits anticompetitive agreements among competitors.[1]

Under the HSR Act, a gun jumping violation occurs when there is a transfer of "beneficial ownership" or "operational control" between the merging parties during the waiting period. Gun-jumping violations are subject to a fact-intensive investigation by the U.S. competition agencies, the Antitrust Division of the Department of Justice (DOJ) and the Federal Trade Commission (FTC). In most cases, there is no bright-line rule for what pre-clearance conduct constitutes a transfer of "beneficial ownership" or "operational control." However, the ends of the spectrum are relatively clear:

- Conduct that indicates the merging parties are operating, pre-clearance, as a single entity will constitute gun jumping. Examples include engaging in joint decision making regarding current or potential customers; placing employees of the buyer in positions at the acquired company; and representing the two parties to customers or suppliers as a single entity.[2]
- Conduct that indicates preparation for post-clearance implementation of the merger will not constitute a gun-jumping violation. Examples include engaging in joint decision making regarding goals and plans for the merged entity; forming transition teams composed of personnel from both the buyer and seller; and exchanging non-competitively-sensitive information for use in integration planning.

Gun-jumping issues also may arise in connection with merger agreement provisions that affect business operations during the waiting period. The U.S. antitrust agencies recognize that buyers need to have input over material changes in the business, such as new "material" contracts proposed between signing and closing that may significantly affect the value of the target business. However, even in this area, DOJ and FTC will carefully scrutinize the parties' conduct to ensure the buyer does not exercise inappropriate influence or control over the target. For example, assume that the contract for one of the target business' largest customers is set to expire after HSR notification but prior to government clearance. The seller needs to

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renegotiate new terms, including contract price and duration, and the result of these negotiations will significantly impact the value of the target business. In the U.S., the buyer can approve or reject the proposed contract that results from the target's negotiations, but the buyer cannot be involved in the negotiations or have dialogue with seller to influence the negotiations without raising gun-jumping concerns. In short, even for material contracts involving the target, the greater the dialogue between the merging parties, the greater the risk of a gun-jumping violation. In addition, if the merging parties are competitors, such discussions also risk Sherman Act § 1 scrutiny.

The U.S. antitrust agencies have been consistently active in this area for several years. For example:

- Some enforcement actions involved clear anticompetitive conduct prior to government clearance. For example, in *United States v. Gemstar-TV Guide Int'l & TV Guide* (2003), the DOJ allegations focused on secret agreements between the merging parties related to customers and prices. The parties agreed to pay a $5.7 million civil penalty as part of a settlement.

- Other enforcement actions have been based on conduct related to provisions in the parties' merger agreement. For example, in *United States v. Smithfield Foods* (2010), the DOJ alleged that the target sought the buyer's approval of ordinary-course contracts in violation of the HSR Act. The parties agreed to a $900,000 civil penalty. Similarly, the FTC's recent guidance on information sharing cited *United States v. Computer Assocs. Int'l* (2002), in which the buyer's pre-approval of certain customer discounts offered by the target resulted in a civil penalty greater than $600,000.[3]

- Still other enforcement actions involved a mix of inappropriate merger provisions and improper exercise of those provisions during the waiting period, as in *United States v. QUALCOMM & Flarion Technologies* (2006), which resulted in the parties paying a $1.8 million civil penalty.

China

China's Anti-Monopoly Law ("AML") is enforced by the newly formed State Administration for Market Regulation ("SAMR"), which combines previously separate enforcement agencies. While this institutional reform may introduce some changes, the provisions of the AML related to gun jumping are not affected by the creation of the new SAMR.

First, like the competition laws in the EU and the United States, China's AML requires notification and a waiting period for concentrations that reach certain thresholds. These requirements create a standstill obligation for the merging parties while the concentration is reviewed by the Chinese authority. For those cases in which the transaction is completed in violation of the AML, Article 48 specifies a range of penalties. The definition of a "concentration" is essential to the SAMR's analysis of potential gun-jumping conduct. According to the definition in Article 20, the acquisition of "control" or the "possibility of exercising decisive influence" is sufficient to constitute a concentration. In this way, the text of the AML is similar to the text of the EC Merger Regulation which, in its Article 3 definition of "concentration," states that control is constituted by any means that "confer the possibility of exercising decisive influence on an undertaking."

Second, it is clear that a gun-jumping violation can occur even if the merging parties' conduct has no effect on competition or on the relevant market. An analysis of competitive effects is a factor only for SAMR's assessment, under Article 8 of the AML, regarding the concentration's effect of eliminating or restricting competition. Competitive or market effects are not a requirement for penalizing the merging parties for gun jumping.

Since the enactment of the AML in 2008, Chinese

antitrust authorities have actively penalized gun-jumping violations by merging parties.

- For example, in 2013, the Chinese antitrust authority imposed its first fine for failure to file a required notification, resulting in a 300,000 RMB fine (approximately $48,000) against Tsinghua Unigroup.[4]

- By 2017, just a few years later, eight penalty decisions were published in a single year, each with fines of 150,000 RMB or more. In addition to this increase in enforcement activity, the recent institutional reform of China's antitrust agencies may contribute to more aggressive antitrust enforcement generally in the coming years.[5]

European Union

The EU has gun jumping rules similar to those in the U.S., which require maintaining the independence of the merging parties during the waiting period and before regulatory approval is received. Both jurisdictions emphasize that gun-jumping violations are fact-specific determinations by the antitrust agencies. And they each recognize that, during the waiting period, the merging parties may take reasonable steps related to preserve the value of the target and plan for post-closing operations.

In a decision applying EU gun-jumping rules, earlier this year the Court of Justice of the European Union ("CJEU") issued a ruling regarding the scope of the "standstill obligation" in EU merger law, which imposes essentially the same requirements (government notification and a waiting period) as the U.S. HSR Act. The CJEU ruled that the standstill obligation prohibits only those actions that contribute to a "change in control" of the target company, regardless of any effects those actions may have on competition. For the first time, merging parties that are subject to regulatory clearance in the EU now have judicial guidance regarding the standstill obligation under the EC Merger Regulation.[6]

The European Commission and national competition authorities have recently levied record fines for gun-jumping violations. For example:

- Earlier this year, the European Commission fined Altice, a Dutch telecom provider, €125 million for taking steps to implement its acquisition of Portugal Telecom before notification or approval of the deal. In announcing the fine, Margrethe Vestager, the EC Competition Commissioner, emphasized the EC's focus on gun jumping and its willingness to penalize individual firms to serve as general deterrence.

- Individual EU member states also are closely scrutinizing potential gun-jumping violations, as demonstrated by the Danish Competition Council's decision in *Ernst & Young* and the French Competition Authority's 2016 decision to impose an €80 million fine against Altice for gun jumping involving two different transactions for SFR and Virgin Mobile France.

The recent Ernst & Young case. Ernst & Young entered a merger agreement to acquire KPMG Denmark target companies in November 2013. At that time, KPMG Denmark was a member of KPMG International, an international network of auditing firms. Although independent companies for the purposes of competition law, the member firms presented themselves to clients as a combined network and operated according to a shared set of professional standards.

KPMG Denmark's membership in KPMG International was governed by a cooperation agreement. The cooperation agreement gave KPMG Denmark the exclusive right to be included in KPMG International in Denmark and to use the trademarks of KMPG International for marketing in Denmark. Under that agreement, the member firms of KPMG International cannot participate in partnerships or joint ventures with third parties. Therefore, the merger agreement between Ernst & Young and KPMG Denmark required

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that KPMG Denmark terminate its cooperation agreement with KPMG International.

Ernst & Young and KPMG Denmark executed their merger agreement in November 2013. The same day, KPMG Denmark privately communicated to KPMG International its decision to terminate the cooperation agreement, effective 10 months later, in September 2014. Soon after, the merger between Ernst & Young and KPMG became public and the merging parties notified the Danish Competition and Consumer Authority.

The merger was approved by the Danish Competition Council in May 2014, but the Competition Council also declared that the action taken by KPMG Denmark to terminate the cooperation agreement with KPMG International constituted a violation of the standstill obligation under Danish competition law. Since the Danish rules on merger control are based on the EC Merger Regulation, the Danish court presiding over the subsequent litigation requested a preliminary ruling from the CJEU regarding interpretation of Article 7 of the EC Merger Regulation and its application in this case.

In May 2018, the CJEU ruled that Article 7, which requires the suspension of certain concentrations to allow for government review, must be interpreted to mean that a concentration is implemented only by conduct by the merging parties that "contributes to a change in control of the target undertaking." Since KPMG Denmark (the target) was independent from the Ernst & Young (the buyer) before and after the termination of the cooperation agreement, that termination could not confer to Ernst & Young "the possibility of exercising any influence" over KPMG Denmark. Therefore, the court concluded that the conduct did not violate EC Merger Regulation's Article 7(1) standstill obligation.[7]

The question of control was dispositive. Evidence that termination of the cooperation agreement was a condition of the merger agreement, that the termination was likely in preparation of and support for the merger, and that it may affect the market in which the merging parties compete did not matter. According to the court, even if all these circumstances are present, "the fact remains that. . . [withdrawal from the cooperation agreement] does not contribute, as such, to the change in control of the target undertaking."

The CJEU explained that the basis for its interpretation of the Article 7 standstill obligation relies on two separate provisions in the EC Merger Regulation: (1) the EC Merger Regulation's general purpose to protect against "lasting damage to competition" and (2) Article 3's definition of a "concentration" as "a change of control on a lasting basis" resulting from a merger or acquisition. For purposes of Article 7, a concentration "arises as soon as the merging parties implement operations contributing to a lasting change in the control of the target undertaking."

The CJEU further explained that its interpretation of Article 7 was consistent with the EC's broader scheme of merger and competition law. On one hand, Article 7 covers a range of actions by the merging parties, since it is irrelevant whether an unlawful implementation occurs by a single action or by achieving "the same result by successive partial operations." At the same time, the CJEU emphasized the need for effective limits on the scope of Article 7. In particular, Article 7 does not require the merging parties to suspend all actions "carried out in the context" of the merger, even if those actions are "ancillary or preparatory to the concentration"—in short, a limit on Article 7 that recognizes the practical need for some type of integration planning prior to regulatory clearance. Further, the scope of Article 7 must be limited to ensure that it does not infringe on and reduce the scope of other EU competition laws, such as the Article 101 TFEU prohibition against coordination among competitors.

Finally, in its interpretation of Article 7, the CJEU was clear that potential effects on competition in the

market are irrelevant to the analysis of the parties' standstill obligation. The court explained that, because the purpose of Article 7 is to suspend all relevant mergers to allow for government review, the interpretation of Article 7 does not vary based on how the merging parties' premerger conduct affects the market. The merging parties' conduct may be relevant to the government's substantive evaluation of the merger, but that substantive evaluation is independent of Article 7's standstill obligation. In sum, even if the merging parties take actions during the waiting period that have "no effect on the market," those actions will constitute a gun-jumping violation if they result in a change of control of the target.

Does *Ernst & Young* Signal Different Rules for Europe Than for the U.S. and China?

EU. Given the absence of case law from the CJEU on the standstill obligation in EU merger agreements, the ruling in *Ernst & Young* provides an important reference point for parties with transactions subject to the EC Merger Regulation. The ruling established that certain measures, although taken during the mandatory waiting period and prompted by a merger agreement, did not affect the standstill obligation because they did not contribute to a shift in control between the merging parties. Whether or not those measures produced market effects did not matter, according to the CJEU.

U.S. Based on its enforcement history, the U.S. antitrust agencies focus on whether the buyer and the target have remained independent entities during the waiting period, similar to the CJEU's reasoning in *Ernst & Young*.[8] In addition, like the CJEU, DOJ and FTC evaluate gun jumping under the HSR Act without any consideration of competitive effects.[9] This suggests that, if confronted with similar facts as in *Ernst & Young*, the U.S. antitrust agencies likely would have arrived at a similar conclusion as the CJEU.

A recent DOJ enforcement action, *United States v. Flakeboard America Ltd.* (2014), which resulted in a settlement with a $3.8 million fine for merging parties due to an HSR Act violation, provides a useful reference point. Similar to *Ernst & Young*, the merging parties' decision to alter the target's business was specified in a provision of the merger agreement. In *Flakeboard*, the merging parties initially intended, as demonstrated by their asset purchase agreement, to close one of the target's manufacturing facilities after the HSR waiting period expired but prior to closing. Similar to *Ernst & Young*, the target business acted on that provision before the government closed its merger investigation. In *Flakeboard*, after the merger agreement was executed, a labor issue arose regarding the facility set to be closed by the target company, which prompted the parties to accelerate plans to close the facility. After discussions with the buyer, and in order to fulfill its obligations under the merger agreement, the target company closed the facility "without regard to whether the HSR waiting period had expired and regardless of whether the underlying transaction was ultimately consummated."[10]

In short, during the waiting period, the targets in each of *Flakeboard* and *Ernst & Young* made a business decision that (a) were rooted in the merger agreement, (b) were made in preparation for the post-closing entity, (c) had potential competitive effects. However, unlike in *Ernst & Young*, where the pre-clearance conduct was limited to termination of KPMG Denmark's cooperation agreement, the conduct in *Flakeboard* went further. According to the DOJ complaint, before expiration of the HSR waiting period, the merging parties moved the target's customers to the buyer, exchanged competitively sensitive information, and coordinated with respect to sales activity.[11] These additional facts in *Flakeboard* suggest that the DOJ's enforcement action may have been motivated by the more obvious gun-jumping violations—for example, the pre-clearance coordinated sales activity—and not by the pre-clearance closing of the target's facility. As DOJ summarized in the *Flakeboard* complaint, the defendants' relevant conduct

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included actions "to close [target's] mill and move the mill's customers to [buyer]—conduct *that together constituted* an unlawful agreement between competitors and prematurely transferred operational control of [target's] business to [buyer]."[12] In sum, *Flakeboard* is a useful reference when considering *Ernst & Young* because both cases contain a key similar fact—the target decides, in accordance with the merger agreement, to leave a market in preparation for post-closing, thus creating potential competitive effects—but *Flakeboard* shows what additional facts would be sufficient to result in a gun-jumping violation under U.S. law.

China. Based on the similarities in China's and the EU's merger statutes and pre-merger regulatory schemes, it is likely that SAMR would have reached the same conclusion as the CJEU in *Ernst & Young*. First, both the Chinese AML and EC Merger Regulation focus on "control" and the "possibility of exercising decisive influence" when determining whether the parties have completed their merger.[13] Interpretation of the merger statute's text was a key factor for the CJEU in *Ernst & Young*, so the fact that China's merger statute has a substantially similar provision indicates that SAMR would reach the same result. Second, other factors relevant to the CJEU in *Ernst & Young*—reference to an overarching statutory purpose to protect competition, premerger review as one part of a broader competition law framework, and the irrelevance of competitive effects for gun-jumping violations—all compare similarly to Chinese antitrust law. Yet given the lack of precedents in China similar to the facts in *Ernst & Young* or to *Flakeboard*, it is unclear exactly what type of post-notification, preclearance conduct by the merging parties would trigger a gun-jumping enforcement action from SAMR. While there have been numerous gun jumping penalty decisions released by the agency, none of the released decisions focused on the pre-clearance conduct of the merging parties. Instead, all those decisions focus on violations related to filing requirements, that is, nonfiling or late-filing for asset acquisitions, share transfers, JV establishments, etc.

Still, regardless of how a case like *Ernst & Young* would come out in China, merging parties with transactions involving China should be mindful of the circumstances that lead to potential gun-jumping violations. Given the rising enforcement activity of the Chinese antitrust enforcers and the lack of clear guidance in the AML, other regulations, and enforcement actions, merging parties subject to the jurisdiction of the SAMR should implement preconsummation procedures related to information sharing and joint business activities to protect against the risk of a gun-jumping violation.

Key Takeaways

Businesses contemplating domestic or cross-border transactions in the U.S., EU, and China should be mindful that the competition enforcement agencies in each jurisdiction are actively investigating and enforcing gun-jumping violations. Merging parties should implement and monitor proper protocols for all merger-related activity prior to notification and government approval in order to avoid a delayed closing date or the risk of monetary or criminal penalties.

In its first ruling on the scope of the EC Merger Regulation's standstill obligation, the European Court of Justice ruled that the conduct of the merging parties constitutes a violation only if their conduct "contributes to a change in control"—regardless of any competitive effects their conduct has on the market. This result is consistent with the expected enforcement approach of the antitrust agencies in the U.S. and China, although evaluating potential gun-jumping violations requires fact-intensive analysis in accordance with each jurisdiction's regulatory scheme.

ENDNOTES:

[1]For more information, see Jones Day Commentary, *FTC Warns Parties on Information Exchanges During M&A Due Diligence* (Apr. 2018), http://www.jonesday.com/ftc-warns-parties-on-information-exchanges-during-ma-due-diligence-04-25-2018/.

[2]Jones Day, *Antitrust Law Answer Book* (2015) at 337-38.

[3]*See* Holly Vedova, Keitha Clopper, & Clarke Edwards, FTC Bureau of Competition, *Avoiding Antitrust Pitfalls During Pre-Merger Negotiations and Due Diligence*, FTC Competition Matters (Mar. 20, 2018), https://www.ftc.gov/news-events/blogs/competition-matters/2018/03/avoiding-antitrust-pitfalls-during-premerger.

[4]*See* Jones Day Antitrust Alert, *China's MOFCOM Fines Merging Parties for Failure to Notify Transaction under Anti-Monopoly Law* (Dec. 2014), https://www.jonesday.com/antitrust-alert—chinas-mofcom-fines-merging-parties-for-failure-to-notify-transaction-under-anti-monopoly-law-12-19-2014/.

[5]*See* Jones Day White Paper, *Combination of China's Three Antitrust Enforcement Agencies May Bring More Aggressive Enforcement Over Long Run* (June 2018), http://www.jonesday.com/files/Publication/e1aa9878-9ac0-43a2-a021-a12b535091ae/Preview/PublicationAttachment/cfcbaa9a-4c2c-4a98-ba63-a8b1e6842fb8/Combination_of_Chinas_Three_Antitrust_r2.pdf.

[6]Judgment of May 31, 2018, Case C-633/16 Ernst & Young P/S v Konkurrencerådet, ECLI:EU:C:2018:371.

[7]Judgment of May 31, 2018, Case C-633/16 Ernst & Young P/S v Konkurrencerådet, ECLI:EU:C:2018:371.

[8]Press Release, U.S. Dep't of Justice, *Justice Department Reaches $5 Million Settlement with Flakeboard, Arauco, Inversiones Angelini and Sierrapine for Illegal Premerger Coordination* (Nov. 7, 2014), https://www.justice.gov/opa/pr/justice-department-reaches-5-million-settlement-flakeboard-arauco-inversiones-angelini-and (" 'Companies proposing to merge must remain separate and independent during the government's investigation,' said Bill Baer, Assistant Attorney General of the Department of Justice's Antitrust Division.")

[9]But note that such competitive effects would be relevant to a Section 1 claim, which may be brought by DOJ in the same action, as it was in *United States v. Flakeboard Am. Ltd.* (2014).

[10]Complaint at 5-6, *United States v. Flakeboard Am. Ltd.*, No. 3:14-cv-4949 (N.D. Cal. Nov. 11, 2014).

[11]*Id.* at 7. *See also id.* at 5 ("Despite the defendants' intentions under the APA, they subsequently entered into a series of agreements and took other actions during the HSR waiting period to close SierraPine's Springfield mill and move the mill's customers to Flakeboard—conduct that together constituted an unlawful agreement between competitors and prematurely transferred operational control of SierraPine's business to Flakeboard.")

[12]*Id.* at 5-6 (emphasis added).

[13]*Compare* AML, Art. 20(3) *with* EC Merger Regulation, Art. 3(1)-(2).

DELAWARE CHANCERY COURT FINDS ABSENCE OF CONTROLLING STOCKHOLDER DOES NOT ELIMINATE POSSIBILITY FOR ADEQUATELY PLED CORPORATE OVERPAYMENT CLAIMS

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On July 26, 2018, Vice Chancellor Glasscock of the Delaware Court of Chancery denied in part and granted in part Defendants' motion to dismiss in *Sciabacucchi v. Charter Communications Corporation et al.*[1] In brief, the action challenged certain transactions between Charter Communications, Inc. and its largest stockholder, Liberty Broadband Corporation, which owned approximately 26% of Charter's outstanding common stock and had the right to designate four of ten directors on Charter's Board. In particular, a Charter stockholder challenged a voting proxy agreement between Charter and Liberty and two stock issuances worth $5 billion made by Charter to Liberty, allegedly as a part of the "financing" of Charter's $78.7 billion merger with Time Warner Cable and its pur-

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