

TRANSACTION “DESIGNED” TO EVADE MERGER CONTROL LEADS TO U.S. AND EU PENALTIES

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Antitrust authorities in the United States and European Union have assessed penalties and fines against Canon, and in the United States, Toshiba, for structuring a transaction to avoid premerger notification filings and waiting period requirements. If the European Commission’s decision stands, Canon will pay more than \$34 million in fines and penalties related to the transaction in the EU, U.S., and China. Toshiba will pay just \$2.5 million in the United States. Antitrust authorities around the world enforce their merger control statutes and waiting period requirements aggressively. Penalties for

gun jumping (either failing to file or observe standstill obligations) are likely to grow as more jurisdictions enact premerger filing and standstill obligations and transactions have an increasingly global dimension.

Background: The Transaction

In March 2016, Canon Inc. agreed to buy Toshiba Corporation’s (“Toshiba”) subsidiary, Toshiba Medical Systems Corporation (“TMSC”). According to the U.S. Department of Justice (“DOJ”) complaint, Toshiba needed the sale proceeds by the end of its fiscal year, March 2016, to shore up its financial statement after financial irregularities became public. Because of this deadline, the parties found themselves without time to obtain merger control clearances before Toshiba’s fiscal year ended.

To circumvent this problem, the parties executed Steps 1 through 3 in the following transaction structure in March 2016, prior to merger control filings:

- Step 1:** Toshiba sold non-voting equity and options in its subsidiary, TMSC, to Canon for \$6.1 billion.
- Step 2:** Toshiba and Canon formed a special purpose company, MS Holding Corporation.
- Step 3:** Toshiba sold the voting equity in TMSC to MS Holding Corporation for \$900.
- Step 4:** Canon exercised options for TMSC voting equity.

The U.S. merger control rules provide that acquisitions of options and non-voting securities do not require a filing under the Hart-Scott-Rodino (“HSR”) Act. Arguably, the \$6.1 billion that Canon paid in March 2016 for the non-voting equity and options did not trigger an HSR filing.

In April, Canon and the shell company, MS Holding Corporation, made an HSR filing related to Step 4, Canon’s acquisition of the voting equity in TMSC. The Federal Trade Commission (“FTC”) determined that Toshiba, rather than MS Holding Corporation (“MS Holding”), should have filed as the seller of TMSC voting equity. In July 2016, Canon and Toshiba made amended filings “under protest” and received HSR clearance following the 30-day waiting period in August 2016. Canon subsequently exercised its options to acquire TMSC’s voting equity for \$1.

Investigations in Japan and China

In June 2016, the Japan Fair Trade Commission (“JFTC”) cleared the transaction but warned the parties that their transaction structure “may be inconsistent” with Japan’s premerger notification

laws, without issuing a fine. The JFTC also warned the parties not to consummate future transactions in a similar structure without first submitting a premerger notification to the authority.

In January 2017, China's antitrust authority, then known as the Ministry of Commerce or "MOFCOM," fined Canon CNY300,000 (approximately \$43,000) for implementing the acquisition prior to obtaining clearance. Maximum gun jumping penalties in China are CNY500,000 (approximately \$73,000), though there has been recent discussion about increasing the maximum fine. This was MOFCOM's first fine for gun jumping in a case that did not involve a company headquartered in China.

The U.S. Authorities Take Action

The HSR Act requires parties to file premerger notification for certain transactions with the DOJ and FTC and observe a waiting period prior to closing. Although many transaction structures may result in no HSR filing, parties may not structure their transaction for the specific purpose of avoiding the HSR Act.

Following an investigation, the government concluded that the parties deliberately structured the transaction to avoid HSR rules and that Canon had acquired beneficial ownership of TMSC in March 2016, long before it filed HSR, and exercised the options to acquire the voting equity. In its complaint, DOJ argued that MS Holdings did not act as an independent owner of TMSC, for example, by holding economic rights associated with ownership of TMSC or exercising day-to-day control over MS Holding's operations. In contrast, DOJ alleged that Canon improperly coordinated with Toshiba to control MS Holding by:

- Consulting a law firm to form MS Holding;
- Drafting and approving the formation documents;
- Appointing the shareholders and principals; and
- Briefing the shareholders and principals.

The current maximum civil penalty for HSR violations is \$42,530 for each day of noncompliance, which could have resulted in a maximum penalty of \$6.36 million for each party. The parties settled with DOJ and will each pay \$2.5 million. According to DOJ, the total penalty was less than the maximum because the parties were willing to settle and avoid litigation.

EU Follows Suit

Like in the United States, EU merger rules require that a buyer (1) notify the European Commission ("EC") of a transaction that meets jurisdictional thresholds prior to closing ("notification

requirement"), and (2) not implement the transaction until it receives clearance from the EC ("standstill obligation").

The EC determined that Steps 1 and 2, *i.e.*, Toshiba's sale of non-voting equity and options in TMSC to Canon for \$6.1 billion and its sale of voting equity in TMSC to MS Holding Corporation for \$900, formed a single notifiable merger. The EC also concluded that Canon violated EC notification and standstill requirements when it implemented Step 1.

Although the EC may impose fines of up to 10% of aggregated turnover of companies that intentionally or negligently breach the notification and/or standstill requirements, Canon's fine totaled €28 million (approximately \$31.8 million). In determining the amount of the fine, the EC considered that Canon was aware of its obligations to notify the transaction and the standstill requirement, and that its breach of those obligations was, "at least, negligent." The lack of any competitive issues with the transaction and the EC's unconditional clearance mitigated the fine.

In a press release, Canon said it disagrees with the EC's analysis that it acquired control of TMSC before the EC cleared the transaction. Canon said it will appeal the decision to the General Court of the European Union in Luxembourg.

Increased Attention to Gun Jumping Globally

This fine is the last in a series of steps the Commission has taken since 2017 to increase enforcement of its procedural rules.¹ This line of cases under the new EUMR clarified the Commission's renewed focus on gun-jumping after a 20 year break,² particularly with regards to partial implementation of notifiable transactions. In May 2017, the Commission launched its first-ever investigation³ regarding the pre-clearance implementation of a notified merger.⁴ The investigation resulted in a €125 million gun jumping fine, imposed on Altice, a French multinational cable and telecommunications company. The Commission found that Altice's agreement to buy PT Portugal allowed it to control its rival before clearance, and that Altice effectively did so by instructing the target on how to handle commercial issues, such as contract negotiations.

The Altice fine was also followed by other investigations and fines for procedural breaches not just limited to gun-jumping/failure to file, but also for the provision of misleading information and breach of commitments. For example:

- In *Facebook/WhatsApp*,⁵ the Commission fined Facebook €110 million for providing incorrect or misleading information during the 2014 investigation Facebook's acquisition of WhatsApp.
- In *Merck KGaA/Sigma-Aldrich*,⁶ the Commission is conduct-

ing an investigation into a possible breach of EU merger rules by providing incorrect or misleading information in the context of a merger.

- In *Telefónica Deutschland*,⁷ the Commission is conducting an investigation into Telefónica Deutschland's potential breach of commitments it had offered to secure the Commission's approval of its acquisition of E-Plus in 2014.

Such cases reinforce the EU-wide and national trend of strict enforcement of procedural merger control rules in recent years. In addition to cases at EU level, several EU Member states also recently issued gun jumping sanctions.⁸ For example, in the UK, the CMA issued its first decision in a gun jumping case via imposition of initial enforcement orders.⁹ This is notable, given the voluntary nature of merger control regime in the UK.

Gun jumping enforcement also is on the rise globally. In 2018, antitrust authorities in jurisdictions such as Australia, Brazil, and Chile opened gun jumping investigations or sought fines for gun jumping violations. In India, a total of 11 fines were imposed in 2018 for such failure to notify or gun jumping. Likewise, Chile amended its merger control law in June 2017 to require its clearance prior closing and imposed its first fines in July 2018 related to gun jumping.

Apart from gun jumping, exchange of commercially sensitive information (*e.g.*, pricing information, future commercial strategy plans, or sensitive customer-specific information) prior to closing also may violate relevant antitrust laws. The Commission and other competition authorities generally acknowledge that legitimate business reasons may exist for exchanging such information prior to antitrust clearance, such as in the case due diligence, negotiation, regulatory compliance, and integration planning purposes. However, the need for the information must be legitimate, the information exchange should be limited to that which is strictly required to serve this legitimate interest, and parties should take the necessary precautionary steps to ensure limited disclosure and guarantee confidentiality of the information (*e.g.*, utilize clean teams or third-party consultants to review competitively sensitive information).

Conclusion

1. Fines for gun jumping are on the rise globally, and this is the latest example. This case also demonstrates how an antitrust investigation in one jurisdiction can spread globally.

2. Cases involving a device for HSR avoidance in the United States are rare. A transaction structure designed to avoid an HSR filing, even temporarily, is likely to result in significant fines. Companies should select a transaction structure on the merits, independent of whether it leads to an HSR filing.
3. While both buyers and sellers make HSR filings in the United States, in the EU, only the party acquiring control makes a filing. This explains why the EU fined only Canon. As the buyer, Canon will pay substantial fines in the EU (approximately \$31.8 million) for agreeing to a transaction structure that accommodated Toshiba's need to receive the transaction proceeds early. Toshiba faces no fine in the EU and a \$2.5 million fine in the United States.

ENDNOTES:

¹See, *e.g.*, J. Laitenberger (Director-General of DG Competition), *The many dividends of keeping markets open, fair and contestable*, St. Gallen International Competition Law Forum, April 27, 2017.

²Case No IV/M.1157 *Skanska/Scancem*, (Commission Decision of November 11, 1998). See also Commission investigations in two cases *Ineos/Kerling* (2007) and *Skanska/Scancem* (1998), where no infringement was found.

³See also Case COMP/M.7184 *Marine Harvest/Morpol* (Commission decision of July 23, 2014) where a pre-notification implementation of Marine Harvest's acquisition resulted in an EUR 20M fine for gun jumping. As in *Altice*, it was found to breach both the 'notification requirement' and the 'stand-still obligation.'

⁴In Case COMP/M.7993 *Altice/PT Portugal* (Commission decision of April 20, 2015). The Commission had previously conducted two investigations for failure to file: See Case COMP/M.7184 *Marine Harvest/Morpol*, and Case COMP/M.4994 *Electrabel/Compagnie Nationale de Rhône*.

⁵Case COMP/M.8228 *Facebook/WhatsApp*.

⁶See Case COMP/M.8181 *Merck/Sigma-Aldrich* (Commission Statement of Objections of July 6, 2017), on-going investigation.

⁷See Case COMP/M.9003 *Telefónica Deutschland/E-Plus* (Commission Statement of Objections of 22 February 2019), on-going investigation.

⁸See, *e.g.*, France: National Competition Authority—Decision No. 16-D-24 of November 8, 2016 *Altice*, Germany: Federal Cartel Office decision of July 6, 2015 in case B2-96/14 *Edeka/Tengelmann*, or Hungary: National Competition Authority—Decision Vj/145/2015 *Cee holding group limited/Olympic international holdings limited* of April 15, 2016.

⁹*Electro Rent Corporation/Test Equipment Asset Management and Microlease* (the CMA's decision was upheld by the Competition Appeal Tribunal in February 2019), and Ausurus Group's purchase of CuFe Investments.