Arnold & Porter

October 11, 2018

Managing Gun-Jumping and Related Antitrust Risks in M&A Transactions

Advisory

EU and US Update

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In M&A transactions, the typical time gap of several weeks or even months between signing a transaction agreement and closing on the transaction creates a dual challenge: preserving the value and independence of the target company until closing and achieving "Day One Readiness" by planning for integration of the target into the acquirer's activities as soon as possible after closing.

When addressing these challenges, the parties need to respect the boundaries set by antitrust laws. Where the transaction is subject to pre-closing merger review in the EU and/or the US, the parties are subject to a standstill obligation imposed by the EU Merger Regulation (EUMR) and the Hart-Scott-Rodino Antitrust Improvement (HSR) Act—the parties may not implement the transaction before clearance is obtained[1] and need to continue acting as independent companies.[2] Not observing the standstill obligation amounts to "gun-jumping."

The parties also must be careful not to exchange competitively sensitive information improperly prior to closing, particularly when they are actual or potential competitors. Information exchange is a potential concern during due diligence as well as integration planning and can be sanctioned under general competition rules prohibiting anti-competitive agreements, such as Article 101 TFEU in Europe and Section 1 of the Sherman Act in the United States.[3] This is true even where a transaction is not reportable. Further, in reportable transactions, improper information exchange also can support a finding that the standstill obligation was not observed.

Infringing these rules exposes the parties to various risks, including significant monetary penalties: a fine up to ten percent of the infringing party's worldwide revenues at the EU level, and civil penalties of $41,484 per day (adjusted annually) in the US for the duration of the violation as well as possible disgorgement of any ill-gotten profits.

This update summarizes the risks and mitigating measures in light of two landmark rulings on gun-jumping rendered by the European Court of Justice (*Ernst & Young*) and the European Commission (EC) (*Altice/PT Portugal*) earlier this year and in light of current US practice.

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[1] In the US, "clearance" typically occurs in the form of expiry or termination of the waiting period.

[2] Similar obligations apply under the merger control laws of most other jurisdictions worldwide.

[3] Again, similar rules apply in many other jurisdictions worldwide.

Perspectives on Current Practice: Europe

Gun-Jumping Under the Merger Rules

It is clearly a violation of the EC rules when parties close a notifiable transaction without making the requisite filings or close the transaction after filing but without waiting for clearance. The EC has adopted a number of fining decisions falling into this category.[4]

A more difficult scenario arises when the parties notify the transaction and suspend closing (e.g., the foreseen transfer of shares or assets) pending clearance, but nevertheless engage in pre-clearance conduct that could be viewed as gun-jumping.

Until recently, there has been no specific precedent or guidance for assessing this scenario under the EUMR.[5] However, in April 2018, the EC imposed a record gun-jumping fine of €125 million on Altice concerning its acquisition of PT Portugal that was notified to and cleared by the EC in 2017.[6] Moreover, shortly after the *Altice* decision, the European Court of Justice in *Ernst & Young*[7] responded to a request for guidance by a Danish court on the interpretation of the EUMR standstill obligation. Both cases address pre-closing conduct in notified transactions.[8]

Altice/PT Portugal

In *Altice/PT Portugal*, the EC took issue with veto rights that the pre-closing covenants in the transaction agreement granted Altice with regard to three categories of decisions concerning PT Portugal:

1. Appointment, termination or modification of terms of employment of any and all officers and directors of PT Portugal, which the EC described as an "undefined class of personnel" as opposed to personnel that are materially relevant to the value of the business;
2. Modifications to PT Portugal's "pricing policy," including "standard offer prices" and standard terms and conditions, which according to the EC amounted to a veto over effectively any and all price changes and all changes to customer contracts, as opposed to material changes that might affect the value of the business; and
3. Entry into, termination or modification of a broad range of commercial agreements and actions of PT Portugal that either (a) exceeded a monetary threshold, described by the Commission as "low" and therefore capturing ordinary-course contracts or (b) were described as "Material Contracts" in the transaction agreement, but, according to the Commission, were poorly defined in the transaction

[4] See, for example, the EC's decisions of February 10, 1999 in Case No IV/M.969—*A.P. Møller*, of February 18, 1998 in Case No IV/M.920—*Samsung/AST*, of June 10, 2009 in Case COMP/M.4994—*Electrabel/Compagnie Nationale du Rhône* (upheld on appeal by the European Court of Justice) and of July 23, 2014 in Case M.7184—*Marine Harvest/Morpol* (upheld by the General Court but currently on further appeal to the European Court of Justice).

[5] The only EU case was *Bertelsmann/Kirch/Premiere* in 1997, which involved a fairly exceptional scenario and did not lead to the imposition of a fine.

[6] Case M.7993—*Altice/PT Portugal*, decision of April 24, 2018 under Article 14(2) EUMR. Altice has lodged an appeal against the decision.

[7] Judgment of the European Court of Justice (Fifth Chamber) of May 31, 2018 in Case C-633/16 *Ernst & Young P/S v Konkurrencerådet*.

[8] The EC is also investigating another case under the gun-jumping rules, *Canon/Toshiba Medical Systems*. See EC press release of July 6, 2017, IP/17/1924.

agreement and, in practice, captured a large of number of arrangements covering day-to-day operations.

The EC recognized that interim operating covenants with veto rights for the acquirer are common and can be proper if necessary to preserve the value of the target between signing and closing. However, the EC held that each of the above-mentioned veto rights went well beyond a justifiable need for value preservation. Importantly, these veto rights also afforded Altice *the possibility to exercise decisive influence* over PT Portugal because they extended to matters decisive in determining PT Portugal's commercial policy. In this context, the EC dismissed Altice's claims that it had not made (significant) use of these veto rights, holding that the mere ability to exercise decisive influence was sufficient to bring about a change in control in violation of the standstill obligation.

Moreover, the Commission found that Altice *had in fact exercised decisive influence* over PT Portugal's business by being directly and heavily involved in decision-making processes of PT Portugal and exercising the excessive veto rights on a number of occasions. PT Portugal also had provided to Altice extensive amounts of sensitive information on PT Portugal's commercial strategy. The information was exchanged outside the framework of any confidentiality or clean-team agreement, well after the due diligence review had been completed, placing Altice "in a position as if it already controlled PT Portugal and was therefore entitled to ask for and receive such information." The actual exercise of decisive influence over PT Portugal prior to clearance amounted to a separate infringement of the standstill obligation.

A key takeaway from *Altice* is that pre-closing covenants, which give the purchaser the ability to control certain commercial decisions of the target, should be limited to what is necessary to maintain the value of the target business—or else risk amounting to gun-jumping (at least if the veto rights confer the acquirer control over the target). Whether control was actually exercised via the veto rights was not considered to be relevant for the assessment of pre-closing covenants in *Altice*. Moreover, the decision makes clear that the parties have to show that veto rights are necessary for value preservation even if the veto right concerns a matter that falls outside the target's ordinary course of business. Finally, to reduce the risk of a finding of actual exercise of decisive influence before clearance, parties would be well advised to closely follow the procedure agreed upon in the covenants and, for example, not ask for the acquirer's consent on items not listed in the covenants or in a way that is not foreseen in the covenants.

Ernst & Young

This case concerned Ernst & Young's acquisition of KPMG Denmark, which was notified to the Danish competition authority. Under the transaction agreement, KPMG Denmark was required to give notice (and actually gave notice) to terminate a cooperation agreement with KPMG International prior to clearance of the acquisition by the Danish competition authority. The Danish authority held that this amounted to gun-jumping in breach of the merger control rules,[9] as handing in the notice led to a lasting change in the structure of the market.[10]

[9] The Danish merger control rules are based on and interpreted in line with the EUMR.

[10] The EC had intervened in support of the Danish Competition Authority, arguing that it is not a prerequisite that a measure forms part of the process leading to the actual change of control, and that partial implementation may arise in respect of preparatory steps allowing the party obtaining control

In its ruling, the Court of Justice disagreed. It held that there is a breach of the standstill obligation *only* where the conduct, in whole or in part, in fact or in law, *contributes to a lasting change in control over the target.* Measures that do not contribute to the change of control cannot amount to gun-jumping even if they are preparatory or ancillary to the change in control. (The Court even stated that measures that are not "necessary" to achieve a change of control cannot amount to gun-jumping, despite the operative part of the ruling arguably using the broader standard of "contributing" to the change of control.) Applying these principles, the Court suggested that the notice given by KPMG Denmark in no way affected its independence from Ernst & Young and, therefore, did not violate the standstill obligation.

The ruling clarifies that it is not decisive for the analysis of gun-jumping under the EUMR whether a measure produces market effects (which KPMG Denmark's notice did produce). The ruling also clarifies that the parties to a transaction can, without infringing the standstill obligation, take certain preparatory steps to implement the transaction as long as these steps do not contribute to a change in control of the target.

Nevertheless, the ruling leaves open the door for the EC to pursue cases of "partial implementation" through measures that "contribute" to a change of control. It remains somewhat unclear what types of measures that would capture and, thus, there may be room for the EC to apply a broad interpretation.

Information Exchange

To avoid antitrust risk as a result of the information exchange that usually takes place between the parties during due diligence and integration planning, those exchanges should be limited to what is necessary for the legitimate task at hand (e.g., risk assessment and valuation). Necessary safeguards should be in place to limit the dissemination of competitively sensitive information relating to the target and avoid such information from being used for purposes other than the legitimate task. Unjustifiably broad information exchange can contribute to a finding of gun-jumping and also be pursued as a separate infringement of the general antitrust rules (e.g., Article 101 TFEU and Section 1 of the Sherman Act).

The EC's decision in *Altice/PT Portugal* clarifies[11] that if appropriately limited and structured, the sharing of the target's information—including highly sensitive commercial information—can be permitted, even if such information is shared with employees of the acquirer. By criticising the parties for not having used formal nondisclosure agreements (NDAs) or clean-team arrangements,[12] the *Altice* decision emphasizes the importance of these mechanisms to reduce antitrust risk.

Altice seems to leave some flexibility regarding the composition of the clean team, with the only requirement explicitly stated being that clean-team members must "not be involved in the day-to-day commercial operation" of the acquirer's business. Importantly, by allowing the acquirer's (nonoperational) personnel to be part of a clean team, the EC implicitly rejects a stricter standard that was suggested in a gun-jumping decision adopted in

to gain influence over the structure or market behaviour of the target undertaking, or otherwise pre-empting the effects of the merger, or affecting the competitive situation.

[11] The EC's analysis was carried out in the context of the EUMR's standstill obligation, although there are no signs that a different approach would apply under Article 101 TFEU.

[12] Clean teams are described in the *Altice/PT Portugal* decision as "a restricted group of individuals from the business that are not involved in the day–to-day commercial operation of the business who receive confidential information from the counter party to the transaction and are bound by strict confidentiality protocols with regard to that information."

2017 by the French Competition Authority under the French merger control rules. That decision could be read to require the exclusion of any acquirer personnel from clean teams.[13] However, the circumstances under which an acquirer's employee, officer or director is "involved in the day-to-day commercial operation" of the acquirer's business is not further explained in the *Altice* decision.

Altice focuses on information exchange taking place during due diligence and is silent on the legitimacy of information exchange that occurs after the transaction agreement is signed for purposes of integration planning (even though Altice had raised the need for integration planning as an argument in its defence). Interpreting *Altice's* silence on information exchange for integration-planning purposes as a suggestion that such practices are illegitimate would appear counterintuitive and at odds with commercial practice and needs. Nevertheless, this silence leaves open how the EC will treat information exchange for integration-planning purposes (as opposed to value-preservation purposes) in the future.

Perspectives on Current Practice: United States

Gun-jumping and improper information sharing continues to be a focus of the Antitrust Division of the US Department of Justice (DOJ) and the Federal Trade Commission (FTC). Historically, enforcement actions have been limited to cases with significant impact on competition. Two recent cases, as well as an advisory published by the FTC on its blog, illustrate the circumstances in which the US authorities typically take action on such issues.

FTC Advisory

On March 20, 2018, the FTC published on its online blog a reminder about gun-jumping and information-sharing obligations during merger negotiations and due diligence.[14] It emphasized that care must be taken by actual and potential competitors alike and highlighted examples of conduct in some of its prior enforcement actions that were objectionable: (i) CEOs repeatedly exchanging company-specific information about future product offerings, price floors, discounting practices, expansion plans, and operations and performance; (ii) parties sharing nonaggregated customer-specific information about current and future pricing; and (iii) parties acting in accordance with a merger-agreement provision that required the buyer to approve seller's customer discounts greater than 20 percent off of list price.

Duke Energy/Osprey Energy

On January 18, 2017, Duke Energy Corporation (Duke) agreed to pay $600,000 in civil penalties to resolve allegations by the DOJ that Duke violated the HSR Act's standstill obligation. DOJ alleged that Duke acquired beneficial ownership and exercised control over the Osprey Energy Center (Osprey) prior to expiration or termination of the statutory waiting period.[15]

As part of Duke's agreement to buy Osprey, a power plant in Florida, the parties entered into a "tolling agreement," which went into effect immediately upon signing. The tolling agreement allowed Duke to control the output of electricity Osprey produced, purchase fuel to supply Osprey, and arrange for transmission of

[13] Decision of the French Competition Authority No. 16-D-24 of November 8, 2017 (Case *Altice/SFR and OTL*).

[14] Avoiding Antitrust Pitfalls During Pre-Merger Negotiations, and Due Diligence (March 20, 2018).

[15] Complaint, *United States v. Duke Energy Corp.*, 1:17-cv-00116 (DDC, January 18, 2017); Competitive Impact Statement, *United States v. Duke Energy Corp.*, 1:17-cv-00116 (DDC, January 18, 2017).

energy Osprey generated, all while Duke retained Osprey's profits and losses. While tolling agreements are relatively common in the industry, DOJ took issue with the specific agreement in this context as it allegedly served no economic purpose other than to facilitate the sale. Indeed, the agency's complaint stated that Duke was unwilling to enter the tolling agreement without the acquisition agreement and desired the tolling agreement to help obtain approval for the acquisition from the Federal Energy Regulatory Commission.

DOJ stated that the penalty imposed on Duke was meant to deter future gun-jumping. It also noted that the penalty was adjusted downward "in part because the Defendant was willing to resolve the matter by consent decree and avoid prolonged investigation and litigation."[16]

Flakeboard/SierraPine

On November 7, 2014, DOJ announced a settlement with two particleboard manufacturers, Flakeboard America Limited and SierraPine, for $3.8M in penalties and $1.15M in disgorgement to resolve HSR Act and information-sharing violations.[17] Notably, this settlement occurred after the parties had already abandoned the transaction due to substantive concerns raised by DOJ during its review.

In the purchase agreement, SierraPine agreed that after HSR Act clearance, but no later than five days prior to closing, it would prepare the shutdown of a mill that Flakeboard was acquiring. Shortly after signing, SierraPine experienced an unexpected labor issue that necessitated that either Flakeboard waive the provision or SierraPine close sooner, prior to HSR Act clearance. Flakeboard refused to waive the provision, so SierraPine began to close the mill early, including by coordinating with Flakeboard to transition SierraPine's customers to Flakeboard's competing mill. As part of the coordination, SierraPine reportedly provided Flakeboard "competitively sensitive information about [the mill's] customers—including the name, contact information, and types and volume of products purchased."[18]

DOJ required penalties of $1.9M per party for the gun-jumping and $1.15M to disgorge allegedly ill-gotten profits from former SierraPine customers under Section 1 of the Sherman Act. DOJ noted that the gun-jumping penalties were discounted from the full penalty available against each party because of their cooperation with DOJ's investigation. With respect to the disgorgement, DOJ stated it was a particularly appropriate remedy in this case because the SierraPine mill had been closed for several months and its employees were gone, making reopening impractical. As part of the settlement, DOJ also imposed behavioral restrictions requiring conformance with gun-jumping and information-sharing limits in future transactions along with a requirement that the parties make annual compliance reports and implement an antitrust-compliance program and officer for the duration of the settlement's 10-year term.

These actions underscore the US agencies' view that merely because parties are engaged in a transaction, they are not exempt from the antitrust laws prior to closing. Indeed, enforcement can occur whether the underlying transaction proceeds or is abandoned due to concerns with its impact on competition.

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[16] Competitive Impact Statement, *United States v. Duke Energy Corp.*, 1:17-cv-00116, (DDC, January 18, 2017), at 6.

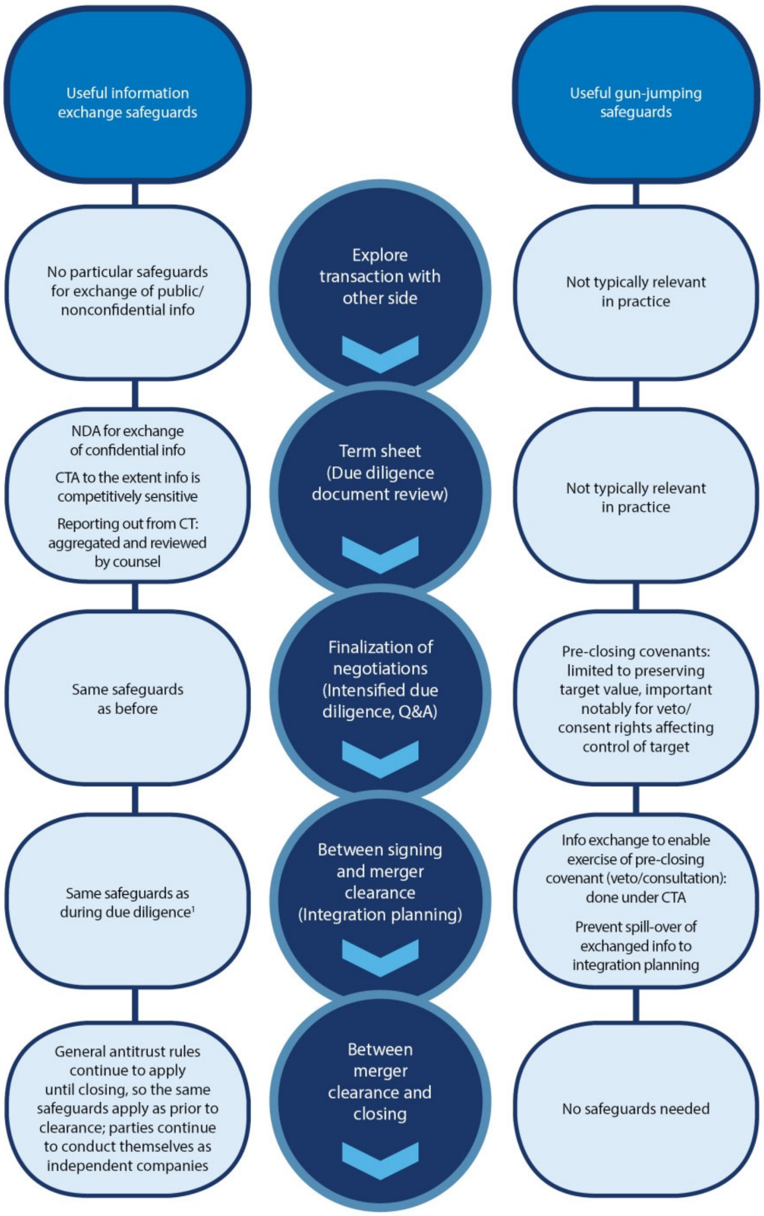
[17] Complaint, *United States v. Flakeboard Am. Ltd.*, Case No. 3:14-cv-4949 (ND Ca, November 11, 2014); Competitive Impact Statement, *United States v. Flakeboard Am. Ltd.*, Case No. 3:14-cv-4949 (ND Ca, November 11, 2014).

[18] Complaint at 6-7, *United States v. Flakeboard Am. Ltd.*, Case No. 3:14-cv-4949 (ND Ca, November 11, 2014).

Managing Risks from Due Diligence to Closing: Practical Guidance

The chart below illustrates the likely points along the timeline of a typical transaction when risks related to gun-jumping and/or anti-competitive information exchange may arise and suggests safeguards that can be used to reduce them.

Useful Safeguards for a Typical Acquisition



NDA: nondisclosure agreement. CTA: clean team agreement. CT: clean team.

1. As noted above, the EC's *Altice* decision does not discuss the legitimacy of information exchange for purposes of integration planning.

Useful Safeguards in Relation to Information Exchange During Negotiation, Due Diligence and Integration Planning

Nondisclosure agreements (NDAs) and clean-team arrangements (CTAs) should be used to reduce risks that arise in connection with the exchange of confidential information as part of negotiations, due diligence and integration planning, as set out below.

NDA	
WHAT	• **Confidential business information of the target** (but detailed, competitively sensitive information should normally be limited to the clean team), e.g., – Aggregated financials – Aggregated cost and customer information
WHO	• **The NDA should limit disclosure of the target's information to acquirer personnel or representatives** with a need to receive confidential information about the target for the purpose of evaluating the deal. Typically includes on the acquirer's side (subject to the need for a clean team): – Business development team members – Management – In-house counsel – Outside advisors (e.g., legal, accounting, etc.)
WHEN	• Entered into **before due diligence commences**. • **Duration**: extends to post-signing, when the parties start planning for integration.
FREQUENT ISSUES	• **Meetings between the parties.** It is recommended to have predetermined agendas to limit the scope for uncontrolled disclosures, and to have counsel present during meetings if the topics on the agenda are particularly competitively sensitive. • **The deal is abandoned.** The NDA should foresee that confidential information that has been exchanged is either destroyed or returned, and that such information should not be used for any other purposes. Persons under an NDA typically will not be restricted in continuing to operate in the buyer's competing business.

CTA	
WHAT	• **Competitively sensitive information of the target**, such as: – Individualized customer and sales data – Detailed pricing and cost information – Customer and supplier agreements – R&D and pipeline information, etc.
WHO	• **Business persons not involved in day-to-day operation of buyer's relevant business** (in particular, avoid individuals with marketing, sales or R&D functions, as well as those having authority/responsibility for pricing or other key competitive decision-making), and only to the extent they have a need to receive the competitively sensitive information for the purpose of evaluating the deal or other legitimate purposes. External advisors are normally included in the clean team as well.
WHEN	• **Entered into** before commencing review of competitively sensitive information. • **Duration**: up to closing.
FREQUENT ISSUES	• **Meetings between the parties**. Same as above for NDA. • Limiting competitively sensitive information shared to what is **necessary for the relevant legitimate purpose** (i.e., valuation of the target pre-signing, or integration planning post-signing) should be done even where a clean team is put in place. • **Reporting out from the clean team** to the broader buyer's deal team and management should only contain clean-team information that is sufficiently aggregated and/or anonymized to remove

	the competitively sensitive nature of the information. Counsel should assist in determining that this requirement is met. • **The deal is abandoned**: – The parties should foresee that confidential information that has been exchanged is either destroyed or returned; – Clean-team members should not be permitted to take up operational, marketing, sales or R&D-related roles (as well as those having authority/responsibility for pricing or other key competitive decision-making) in their company's relevant business until the competitively sensitive information becomes stale, typically for six to 18 months after the abandonment of the transaction.

Useful Gun-Jumping Safeguards in Relation to Pre-Closing Covenants & Integration Planning

PRE-CLOSING COVENANTS	
LEGITIMATE PURPOSE	• The legitimate purpose of pre-closing covenants is the **preservation of the target's value in the period between signing and closing**, before the buyer is able to take over the management of the business in accordance with its preferred commercial strategy.
DRAFTING CONSIDERATIONS	• The wording and scope of the covenants should strictly reflect the legitimate purpose described above, in particular: – **Pre-closing covenants that arguably confer control should be avoided**. Under *Altice*, covenants affecting control in the sense of the EUMR would undergo strict scrutiny as to their necessity for purposes of value preservation. – **Pre-closing covenants should <u>not</u> cover ordinary business decisions**, such as the setting of everyday prices, standard negotiations with customers or participation in ordinary-course commercial agreements. – **Materiality thresholds** (e.g., those defining "material contracts" that require consultation with the buyer) should be set at an appropriate level so as not to capture routine actions of the target that would not impact the target's value significantly. – **The type of the acquirer's right** (a veto, a right to consent, such consent not to be unreasonably withheld, or a consultation right) is relevant in considering risk, but as a rule will not be sufficient to remove concerns with a covenant framed too broadly (e.g., even a consultation right may raise concerns if too broadly framed).
POST-SIGNING ISSUES	• Buyer should take a **conservative approach when exercising its rights under pre-closing covenants**, even where the covenants are diligently drafted. • Buyer should **avoid becoming involved in the target's business outside the scope of the covenants**. Seeking input from counsel regarding the exercise of interim operating covenants is prudent to capture any inadvertent scope creep. • **Competitively sensitive information necessary for the buyer to exercise its rights under the pre-closing covenants should be exchanged under a CTA**.

INTEGRATION PLANNING	
PLANNING AND LIMITED IMPLEMENTATION	• The parties' integration-planning activities should be restricted to making plans for the new company, necessary for "Day One" readiness: **implementing those plans into action must wait until after closing**. • Information sharing for purposes of integration planning can raise particular risk and needs to be carefully set up. See the section above on information exchange. • In exceptional circumstances, very near the date of closing, it may be possible to begin implementation of certain actions that are not competitively sensitive. These should be carefully discussed with counsel.

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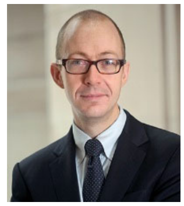

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