ECLF Position Paper: the need for guidance on early implementation

1. The need for guidance

Pre-completion conduct in context

1.1 Competition Authorities have historically penalised only the most clear-cut breaches of the standstill rules – i.e., closing pre-clearance. But there has been a recent uptick in strict enforcement of the rules in many jurisdictions. Meanwhile, the clear trend of longer merger review periods has put merger parties under pressure to carry out more thorough integration planning, and to include more stringent pre-closing covenants, etc., to ensure that acquisitions retain their value whilst the parties await merger clearance, so that they realise their expected synergies from "Day 1".

1.2 Against this background, it is necessary to strike a balance between the Authorities' desire to ensure their rules are being followed, and the legitimate commercial motives that drive businesses to ensure the success of their M&A plans. The best way to achieve this is to provide clarity and certainty about where the boundaries of gun-jumping lie.

Why guidance is needed

1.3 The current state of the law does not provide adequate certainty. The Commission's *Altice* Decision is helpful but leaves a number of questions unanswered. Similarly, the Danish *Ernst & Young* case resulted in additional guidance from the ECJ, it added to commercial anxieties about the risk of over-zealous enforcement by Competition Authorities, given that the gun-jumping formula established in the Ruling leaves scope for interpretation.

1.4 This unsatisfactory state of affairs suggests that the time is right for the Commission to provide merging parties with a clear and unambiguous path through the merger review period, and to avoid a situation in which legal uncertainty causes parties to put off reasonable and efficient deal planning.

1.5 This is especially true given that the European Commission is a thought leader for Competition Authorities globally: some other authorities have or are starting to prepare their own guidance, and it would be preferable for the Commission to take the lead in this process.[1] A published EC view would also give DG COMP case teams the confidence to

[1] For example, in Brazil, the Administrative Council for Economic Defence (CADE) issued its "Guidelines for the analysis of previous consummation of merger transactions" in March 2015 (the English version available here: http://en.cade.gov.br/topics/publications/guidelines/guideline-gun-jumping.pdf). Similarly, in March 2018 the U.S. Federal Trade Commission (FTC) published guidance on the risks of sharing information with a competitor before and during transaction negotiations (available here: https://www.ftc.gov/news-events/blogs/competition-matters/2018/03/avoiding-antitrust-pitfalls-during-pre-merger). In France, the *Autorité de la concurrence* has recently submitted a paper to the OECD outlining its approach to gun-jumping (*Suspensory Effects of Merger Notifications and Gun Jumping - Note by France*, 27 November 2018, available here: http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/WD(2018)121&docLanguage=En).

provide guidance on these issues on live cases – at present, there is little predictability on whether guidance will be available, and what form it will take.

Format of guidance

1.6 Guidance need not be exhaustive nor voluminous, but should ideally lay down clear principles, and provide a range of reasoned examples of conduct that does and does not constitute gun-jumping. While no guidance can be comprehensive, such examples would confer some certainty with regard to the great majority of queries to which there is no clear answer available in the current state of law and guidance. In the following sections, we have set out areas which we consider should, at a minimum, be covered in the guidelines.

Availability of case-specific guidance

1.7 Pending the publication of guidance, the Commission could also help merging parties by indicating that it is open to providing them with situation-specific guidance during the course of the merger review. This change could be implemented more quickly than the publication of guidance, and would be a welcome stop-gap measure.

2. Where is the line drawn between Article 101 and Articles 4/7 breaches?

2.1 EU competition law acknowledges that – subject to certain limitations – merging parties have a legitimate interest in the exchange of information about each other's businesses in the context of negotiations, due diligence and integration planning. However, following the Commission's *Altice* Decision, there is significant uncertainty whether exchanges of competitively sensitive information in an M&A context is governed by Article 101 TFEU, Articles 4 and 7 EUMR, or both.

2.2 The choice of legal basis may have significant consequences, in terms of the scope of permitted information exchanges, the possible sanctions for breach and the addressee(s) of any infringement decision. The limits of information exchanges between companies are relatively clear under Article 101 TFEU, with arguably only exchanges of competitively sensitive information between competitors being caught. Conversely, the only obligation under the EUMR is the standstill obligation in Articles 4 and 7 EUMR, which do not readily seem to apply to information exchanges.

2.3 In its recent Judgment in *Ernst & Young*, the ECJ held that the EUMR standstill obligation must be interpreted narrowly and its application be limited to the implementation of a "concentration" within the meaning of the EUMR, namely a "*transaction which, in whole or in part, in fact or in law, contributes to the change in control of the target undertaking".* On this basis, it would appear that an exchange of information cannot in and of itself be considered to violate the EUMR standstill obligation (unless the exchange of information could somehow be said to confer to control). However, the Commission in its *Altice* Decision (issued a few weeks before the ECJ Judgment) seems to suggest that there may be circumstances where the exchange of competitively sensitive information can, of itself, amount to a breach of the standstill rules.

2.4 Given the foregoing, we think that clear guidance is needed from the Commission with respect to the limitations on information exchange in the context of an M&A transaction, and the legal basis governing those limitations.

3. The line between planning and implementation

3.1 On its face, it appears to be a straightforward proposition that, prior to receiving merger clearance, an acquiring company can plan for the integration of a target company but cannot implement any of that plan (at least insofar as such implementation would constitute control). In practice, however, it can be very difficult to determine whether certain acts undertaken prior to clearance fall clearly within the ambit of lawful planning or, by contrast, unlawful implementation. This can create significant uncertainty for the merging parties, especially during a lengthy review period, when the parties inevitably want to use that period to perform a significant amount of integration planning.

3.2 There are, of course, obvious examples of behaviour that if undertaken prior to receipt of merger clearance would constitute implementation of the transaction and therefore a gun-jumping violation. This would include actions such as the transfer of beneficial ownership of the target to the acquirer, with the acquirer exercising operational control or day-to-day decision-making over the target's business, and/or the acquirer amending the target terms and conditions to be applied to customers, even if limited to sales that will be completed after receipt of clearance.

3.3 However, there are other types of behaviours that are more ambiguous. Issues most frequently encountered include:

(i) **Joint customer outreach**: To what extent can the acquirer and target meet jointly with customers, particularly mutual customers? There are multiple reasons to do so, including to explain the rationale of the transaction and thereby safeguard the commercial relationship and answer the questions which customers may have. Frequently, customers ask to meet with the acquirer and target jointly to understand the impact of the transaction on their business. Customers also often try to conduct mutual negotiations with merging parties to reduce their own workload.

(ii) **Joint outreach to future suppliers**: In cases where the integration of the merging businesses will require external service providers (e.g. engineering companies or hardware suppliers required for the integration of two mobile networks), the parties have a legitimate commercial interest to start the process of selecting future suppliers during the review period so as to be able to begin the integration as soon as possible after clearance. This raises the question whether companies are permitted to engage in all or any of the following as regards future supply contracts: agreeing on the tender parameters, preparing the tender documents, contacting potential suppliers, sending the tender documents to potential suppliers, and/or engaging in first exchanges with the bidders. The fact that these activities would only take effect once clearance is given would appear to qualify this as a permissible preparatory activity.

(iii) **Research and development**: At what point can the acquirer and target start to make plans for research and development that they will conduct post-closing? In advance of clearance/closing, the convention is that the merging parties must proceed independently with overlapping and costly research and development projects, even though the rationale of the merger might be to consolidate these activities. But what does this really mean, given that the individuals involved (none of whom are likely to have had any role in the transaction negotiations) may feel they are wasting their time?

(iv) **Human resources**: Employee issues raise special difficulties. In advance of closing, employees of both the acquirer and target understandably want to know whether they have a future with the merged company. This begs multiple questions, including whether the respective HR departments can meet to discuss redundancies, whether (and when) the acquirer's HR department can confirm to the target's employees that they have, or do not have, a position in the merged company, and (when unions/works councils are involved) to what extent an acquirer can join negotiations with unions/works councils that concern the target's employees, in order to provide them with the assurances they are likely to be seeking. It is impractical and potentially economically harmful to assert that acquirers are never allowed to deal with employee concerns pending clearance/closing.

(v) **Financial agreements, accounting, and bank-related issues**: Pending clearance/closing, at what point can an acquirer start taking initiatives in relation to the target's bank accounts and loans (e.g., the refinancing of loans)? Can the acquirer provide arm's length financial support to the target in circumstances where this is necessary to keep it afloat? Also, when can an acquirer test the target's existing accounting systems?

(vi) **IT and other systems**: At what point can the acquirer and target start to make changes to their respective IT systems in order to prepare for post-closing migration or the consolidation of these systems? In industries that are heavily reliant on complex IT platforms (such as telecommunications), migrating customers from one platform to another can take several years. For this reason, parties are likely to want to prepare as much as possible in advance of closing for this migration – especially if they are subject to a lengthy review period. This might involve, for example, an exchange of technical know-how and/or some pre-closing development on the acquirer's or target's systems. It is often unclear in this context where the boundaries between planning and implementation lie.

(vii) **Unilateral conduct**: Pending clearance/closing, unilateral conduct by the acquirer and/or the target to change their respective business operations may be problematic. The general rule is that absent an agreement between the acquirer and target, unilateral conduct would not constitute an act of implementation. However, it is often not clear to what extent certain types of conduct, such as abandoning products and/or services, decisions with regard to the refurbishment/construction of manufacturing plants, abandoning research and development projects, and/or changing suppliers in anticipation of closing, could be (mis)construed by a Competition Authority as examples of premature implementation of the transaction. Are merging competitors – and more importantly their staff – really supposed to pretend that the pending transaction is not happening?

4. The role of transaction documents

4.1 Restrictive covenants are standard commercial practice in almost all transaction documents. Whenever there is a gap between signing and completion, the purchaser will inevitably wish to ensure that the value of its investment is not threatened by the acts (or omissions) of the target/seller. Such clauses are therefore better viewed as being ancillary, in that they are necessary for the proper and healthy functioning of M&A transactions.

4.2 The mere existence of a restrictive covenant for the period between signing and completion should not necessarily amount to a gun-jumping violation. However, the Commission's *Altice* Decision confirms that – depending on their precise terms – certain restrictive covenants *can* constitute a gun-jumping infringement regardless of whether such clauses are ever in fact enforced.

4.3 Clear and unambiguous guidance is therefore needed, particularly as key elements in the *Altice* Decision are redacted.

4.4 In the absence of such guidance, restrictive covenants will require even greater consideration and negotiation. This risks causing delay to ordinary course M&A activities, and compels merging parties to incur unnecessary legal costs. The suggestion in the *Altice* Decision that parties seek a derogation from the Commission under Article 7 EUMR for restrictive covenants would not only impose additional regulatory hurdles on the merger parties and create undue delay, but would also needlessly increase the Commission's workload.

4.5 To assist the M&A and antitrust communities, the Commission's guidance should:

(i) **Clarify whether – and in what circumstances – consultation rights constitute veto rights capable of constituting a gun-jumping concern**.

(ii) **Provide clear guidance on permissible "materiality" and monetary thresholds** for restrictive covenants, taking account of the relevant sector/industry of the target business, and in line with market practice (perhaps with examples or ranges), which should also make it clear:

(a) that the parties are free to impose thresholds that may differ from the existing governance principles of the seller or the target business (i.e., the purchaser should be free to negotiate this in the light of preserving its best interests as long as the thresholds are appropriate and fall within the Commission's guidance);

(b) that transaction documents need not set out specifically each and every conceivable matter over which a restriction may be asserted;

(c) that the mere number of contracts covered by a restrictive covenant does not indicate that the clause is not justified; and

(d) that a restrictive covenant will not be deemed to be in breach merely because it is broadly drafted (as the breadth of a clause may provide efficiency in the drafting and/negotiating process).

(iii) **Clarify that acquirer approval rights are permitted in relation to long-term and irreversible strategic business decisions that are capable of affecting the value of the target.** Buyer approval rights should be justified in situations where the seller/target company plans to take strategic commercial decisions which could have a long-term and irreversible impact on the business and the profitability of the target (e.g. a decision to enter into a high-value & long-term committed supply agreement with a supplier). Often, these decisions will be caught by the materiality thresholds referred to in sub-paragraph (ii) above. But where they are not caught, it would be inappropriate for the buyer to be unable to have a say in a decision for which it – not the decision maker – will bear the economic consequences. Approval rights of the buyer in such exceptional circumstances should therefore be justified.

(iv) **Clarify that it is not intended that gun-jumping rules should dictate how corporate due diligence should be undertaken**, notwithstanding comments in the *Altice* Decision linking the acceptability of covenant thresholds and the scope of the due diligence exercise – the fact that a contract was not disclosed in due diligence should not mean that it cannot be covered by a restrictive covenant (as the parameters of the due diligence exercise may be heavily influenced by many factors - including the sale process, the decisions of the purchaser and its financial advisors, the economic context in which the deal takes place, etc.).

(v) **Clarify whether/when more extensive restrictive covenants may be justified**, e.g., where the economic or commercial background indicates the target may be at risk, where it is understood that the period between signing and closing will be especially lengthy, etc.

(vi) **List separately and clearly the types of restrictive covenants that can and cannot be included in transaction documents** – e.g. in the *Altice* Decision, the Commission clearly accepted that the clauses in relation to contracts, trading or financial arrangements with the seller, the payment of dividends, capital contributions, reserves, premiums or other distributions and the settling of litigation, were acceptable.

(vii) **Clarify whether, in order to give rise to a gun-jumping concern, the restrictive covenant in question needs to have had an impact on the target's business** – e.g. it is conceivable that covenants which, on their face might go beyond preserving the value of the target, do not in fact have any real impact on the day to day running of the target's business.

(viii) **Clarify whether and in what circumstances payment of the purchase price in part or in full ahead of closing constitutes a gun-jumping infringement, even if no shares/assets are otherwise exchanged until completion**.

(ix) **Offer a pragmatic solution on personnel-related restrictive covenants**. Clear guidance is required as to whether the purchaser can protect its investment against the hiring of an unwanted or expensive director/officer or the termination of a desired or valuable director/officer, and whether it is necessary to provide actual lists of individuals/roles subject to this covenant. Guidance should also discuss whether exceptional changes to the terms of any director/officer's contract are necessarily "ordinary course" actions – for instance, a grant of significant bonuses, shares, incentives to senior management may entail significant costs or have other unintended consequences from which the purchaser may wish to be protected.

5. Cooperation and other measures falling short of control

Co-operation that does not amount to a concentration

5.1 Guidelines of the Commission should make it clear whether gun-jumping rules apply to transactions – even when they are entered into between merging parties – that do not constitute concentrations within the meaning of Regulation 139/2004 (in accordance with the ECJ's Judgment in *Ernst & Young*).

5.2 Our view is that they should not apply for example, to agreements on joint purchasing, joint selling or R&D since they do not entail any acquisition of control or the creation of a full function joint venture. This is also the case for the acquisition of minority shareholdings which fall short of control (see further paragraph 5.6 below) and the acquisition of joint control over a non-full function JV which does not constitute a concentration (as decided by the ECJ in the *Austria Asphalt* case).

Concentration that does not trigger a change of control

5.3 According to Article 3(4) of Regulation 139/2004, a concentration can also arise from "*the creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity*". The standstill requirement and therefore also the gun-jumping prohibition apply to this type of concentration. However, this type of concentration does not trigger a change of control so it is difficult to fit into the logic of the *Ernst & Young* case, which deals with this notion of "control" (with the Decision suggesting that a "*concentration is implemented **only** by a transaction which, in whole or in part, in fact or in law, **contributes to the change in control** of the target undertaking*" – emphasis added). Note that the ECJ concludes in *Ernst & Young* that the standstill obligation applies to concentrations as defined in Article 3 Regulation 139/2004, and does not exclude transactions under Art. 3(4).

5.4 Parties to the creation of a full function joint venture (or to the modification of an existing joint venture, from non-full function to full function) require guidance as to which steps can be undertaken without triggering a violation of the standstill requirement. For example, can the parties to the proposed joint venture start selecting future suppliers to the joint venture? Can they enter into a lease agreement with a third party for the premises of the JV? None of these acts constitute the setting up a full function joint venture, and therefore no gun-jumping should occur here; however, Competition Authorities are keen to remind parties that partial implementations amount to gun-jumping just as much as total implementations. Similarly, for the (already jointly controlled) joint venture which is set to become full function, can the parties assess the viability of that idea by agreeing a business plan, or identifying key (new) staff to implement it?

5.5 In this delicate context, parties tend to adopt common sense rules such as ensuring that (a) there is no anti-competitive information exchange, and (b) no act undertaken in preparation for the implementation of the transaction, has any effect on the market on which the JV is or will be active. The Commission's guidelines should lay out similar rules, making it clear that, where they are complied with, there could be no allegation of gun-jumping.

Transactions in stages and stake-building

5.6 The Commission guidance should also confirm that stake-building (i.e., acquisitions of minority shareholdings in the target) in the context of a takeover is not subject to the standstill obligation as long as the acquisition of the stake is not conditional on the main acquisition of control going through – even if the ultimate objective of the stake-building transaction is to acquire control of the target. In doing so, the guidance could also clarify the point in time at which the suspension obligation would start to apply in these circumstances, which we would expect to be at the point of a stake-building acquisition that is conditional on the main acquisition, and not beforehand.

5.7 A practical example in this respect can be found in the context of a firm considering an acquisition or a public takeover that acquires (or agrees to acquire) a block of shares in the target from a third-party shareholder so as to position itself for the subsequent negotiations or takeover bid. It is currently unclear as to the extent to which the upfront acquisition of such a minority stake (e.g. 5%, 10% or 15%) would be subject to the suspension obligation – in particular where the deal is not conditional upon the main deal taking place, but where it is to occur within a short timeframe before the main deal and where it is strategically linked to the main deal.

6. Role of clean teams

6.1 Clean teams can be an important tool in negotiating and executing M&A transactions. They enable commercial due diligence, the evaluation of synergies, and planning for the implementation of proposed transactions, as well as the undertaking of antitrust analyses, to occur, while restricting the exchange of competitively sensitive information between the businesses.

6.2 In many transactions, merging parties rely on clean team structures to achieve the minimum level of information exchange while enabling the functions described above to be performed effectively. At the same time, it is important for businesses to minimise the disruption caused to their continuing operations by the use of clean teams (*e.g.* due to the need to quarantine certain clean team members). The Commission's *Altice* Decision is helpful in this respect but additional guidance from the Commission should at a minimum address the following key points.

(i) **When clean teams are needed and for what purpose**. Our view is that clean teams should only be needed exceptionally where the exchange of genuinely competitively sensitive information between merging parties is needed in order to complete the tasks described in paragraph 6.1 above. It would be useful if the Commission could clarify whether during a due diligence period the establishment of a clean team is necessary at all (the *Altice* Decision, at paragraph 437 and elsewhere, is unclear whether there is such need during this period).

(ii) **The permitted scope of the clean team**. We would typically expect a clean team to include individuals from at least the acquirer but may need to involve individuals from each business involved in the transaction, e.g., for the assessment of synergies. None of those individuals would be in day-to-day commercial decision-making roles in areas where the merging parties compete and where the relevant information exchanged could impact upon decision-making. In-house counsel and corporate and finance representatives, in addition to their respective external advisers (which may include retired former employees of merger parties) may also need to be part of the clean team.

(iii) **The types of information that should be restricted to the clean team**. This would naturally build on the guidance on information exchange in the horizontal cooperation guidelines, but should take due account of the M&A context – and therefore legitimate purpose – underlying the request. Guidance should also state that clean team members can provide information to other employees in their business *e.g.,* through aggregated summaries/reports.

(iv) **Safeguards expected to be put in place in respect of the clean team structure.** We would normally expect the information exchanged through the clean team structure to be labelled as such and to be kept (in both physical and electronic form) in a manner that means it is not accessible by other employees of the businesses. Records should be kept of all information exchanged through the clean team structure. In addition, it is common practice for clean team members to sign individual confidentiality agreements.