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'Gun jumping' – guidance for merging parties

M&A and Antitrust

Increased scrutiny of pre-closing conduct

As antitrust authorities around the world step up enforcement of rules requiring **full business separation** pending clearance (see further 10 Key Themes - deal risk) a key risk area is the level of influence buyers exercise over a target's business, with heavy penalties being imposed on buyers who cross the line and exercise control (or have the right to exercise control) too early ('**gun jumping**').

While most authorities allow buyers to take reasonable and necessary steps to **protect the value** of their investment, deciding what is appropriate in practice can be difficult, particularly when parties face extended periods of regulatory review.

Recent cases have shown that the cost of getting it wrong can be staggeringly high. Managing these risks requires a thorough understanding of the rules in each jurisdiction and robust procedures that safeguard against possible infringements.

Key antitrust principles

Most antitrust authorities operate 'suspensory' merger control regimes, which impose strict prohibitions on parties taking any steps which could be construed as early integration. Authorities want to ensure that **pre-merger conditions of competition** are fully maintained until they have decided whether the deal should go ahead.

Pending clearance, merging parties must act as **independent competitors**. This means no integration, exercise of management control, joint marketing, coordination of commercial behaviour or uncontrolled sharing of commercially sensitive information.

To allow buyers to protect the value of their investment, they are generally allowed to limit a target to its **ordinary course of business** and impose financial penalties for any reduction in value from non-ordinary course decisions.

Buyer consent rights for **non-ordinary course** decisions are also generally acceptable, but caution must be exercised:

- thresholds must be set at the right level to avoid any influence in practice over ordinary course activities;
- consent rights must be strictly limited to actions which are necessary to protect the value of the target; and
- commercially sensitive information must be limited to appropriately structured and constituted ring-fenced clean teams.

Recent developments globally: areas of risk

Recent cases have highlighted the key risk areas for buyers in structuring and implementing 'gap controls'.

In **Europe**, the European Commission (in 2018) and French competition authority (in 2016) imposed record fines of **€125 million** and **€80 million** respectively on cable and telecoms company Altice for 'gun jumping' on three separate deals. Three types of infringing behaviour were viewed together as allowing Altice to exercise control over target businesses before the deals were cleared:

- **Rights granted in purchase agreements** allowed Altice to veto decisions and intervene in the target's business beyond what was necessary to preserve value.
- Altice **exercised control in practice** over operational decisions that did not impact target value, including marketing campaigns, commercial contracts and future investments.
- Significant and regular **exchanges of commercially sensitive information** took place without proper safeguards being in place which contributed to Altice's exercise of control over 'day-to-day' operations.

In May 2018, the EU's Court of Justice held that the suspension obligation is only breached by actions which contribute to a change in control, although behaviour falling outside scope may still be caught by the prohibitions on restrictive practices (see further EY/KPMG).

In the **US**, the Department of Justice (in 2017) fined Duke Energy $600,000 for violating the waiting period by entering into a tolling agreement which transferred beneficial ownership of the target's business to Duke before the review period had ended. In 2014, the DOJ imposed fines and disgorgement obligations totalling nearly $5 million on merger parties (Flakeboard and SierraPine) who coordinated to close one party's particleboard facility and transition customers to the other party's facility during the waiting period; the parties eventually abandoned the merger after the DOJ expressed concerns.

In **Asia**, China's Ministry of Commerce (in 2017) fined a Japanese company RMB 300,000 (approximately $43,000) for failing to notify a two-step transaction which should have been notified before implementation of step one. The European Commission is also investigating whether this 'warehousing' structure breached EU merger control rules.

These cases illustrate that, although procedural differences exist across jurisdictions, there is a considerable degree of consistency in the types of behaviour which are likely to be challenged.

Ground rules for M&A transactions

Merging parties must manage their interactions between signing and closing very carefully in order to avoid exposure to significant fines. The following 'ground rules' should be followed:

1. **'Ordinary course of business'** clauses (where targets are prevented from taking decisions or making investments outside the ordinary course) are generally acceptable provided any purchaser consent rights for actions outside the ordinary course are strictly limited to those which are necessary to preserve the target's value.

2. **Financial thresholds** restricting the target's conduct or any express list of restrictions must be set at an appropriately high level. If the bar is too low, there is a risk that authorities may interpret the contract as conferring control over the target business. Buyers should look at benchmarks in the target to assess the value of contracts typically concluded and determine the thresholds for actions which would impact value.

3. **Purchase price adjustment clauses** allowing for ex-post adjustments to the purchase price if the sellers take decisions that are detrimental to target value, or **financial penalties** for deviating from the ordinary course, are also generally acceptable provided the thresholds for non-ordinary course actions are set at the right level to preserve value.

4. **Disclosure of confidential, competitively sensitive information** must be strictly limited to what is necessary for legitimate due diligence and integration planning and formal structures (such as clean teams, clear rules on reporting out/into the clean teams, and ring-fencing mechanisms) must be put in place and fully complied with. Any information exchange must not impact the target's day-to-day operations.

5. Particular caution must be exercised when taking any decision that can be construed as taking **steps towards implementation**: even unilateral measures taken in anticipation of the merger can be problematic.

In cases of doubt, parties should consider approaching the authorities to request confirmation that the measures do not consitute 'gun jumping' or seek a formal derogation from the suspension obligation. In certain jurisdictions, for example, if a target is in financial difficulty targeted actions by the buyer may be acceptable provided the authorities' consent has been obtained.

If further information on how to minimise the risk of 'gun jumping' in practice would be helpful, please get in touch with a member of our antitrust, competition and trade group.

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