

The Wait Is Over – Implementing Cross-Border Corporate Transactions by Carve-Out before Final Merger Control Clearance

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Overview

Cross-border corporate transactions often require merger clearance by several competition authorities before they can be implemented. If the parties are working to a tight schedule and the necessary approval in just one last jurisdiction is still pending, a carve-out of this jurisdiction may be an option in order to be able to implement the rest of the transaction. This article demonstrates that, while competition authorities are generally critical of such solutions, a carve-out may be a real alternative in certain circumstances.

Introduction

Most merger regimes are suspensory, i.e. if a corporate transaction is caught by the regime's notification requirements, it may not be implemented before the competition authority has issued clearance (**suspension obligation**). National suspension obligations typically suspend the transaction at an international level, i.e. the transaction may not be implemented globally until all required national approvals have been obtained.

This may cause significant delays. The parties must await merger clearance even if the country in which the transaction has not yet been cleared is of only minor economic significance for the transaction overall. If, for example, a company which operates almost exclusively in the U.S. is bought and the transaction is subject to merger control there, but also triggers a notification obligation in Germany, the entire transaction may be implemented only after it has been approved by both the U.S. and the German competition authority. Such delays are a frequent possibility in global transactions, where it is now not uncommon to see merger clearances being required in ten or more jurisdictions.

However, in some cases, it may be crucial for the parties that at least parts of the overall transaction (e.g. relating to particular divisions or jurisdictions) have been implemented by a particular date. One reason may be that the parties could face substantial financial loss if implementation is delayed (for instance, due to lost profits). In these circumstances, the parties may try to resolve the situation by temporarily carving out from the overall transaction the part of the transaction in the country which has yet to issue clearance (**Carve-Out**) and having it held separately by the seller pending clearance (hold-separate). The parts of the transaction for which no merger control clearances were required or in respect of which clearances have already been issued can then be implemented.

Unfortunately, only very few jurisdictions have specific legal requirements covering Carve-Outs. Additionally, only a very limited number of published decisions by competition authorities deal with the subject. Since a Carve-Out which is not accepted by a competition authority is automatically classified as (a partial) implementation of the proposed transaction and, therefore, as a breach of the suspension obligation (often referred to as "gun jumping"), this legal uncertainty is unfortunate. Jumping the gun bears significant risks for companies, particularly as this is a current priority enforcement area for many competition authorities and heavy fines may be imposed.¹

This article outlines the possibilities for Carve-Outs in cross-border corporate transactions.² It opens with a brief description of the suspension obligation and possible alternatives that may be worth considering before pursuing a sometimes complex Carve-Out. The article then outlines potential provisions to be included in share (or asset) purchase agreement (**SPA**) to cover a

¹ In 2016, for instance, the Brazilian competition authority sanctioned what it regarded as an insufficient Carve-Out with a fine equivalent to EUR 6.7 million. The second highest fine to date (amounting to EUR 4.5 million) for an unlawful Carve-Out was imposed by the German competition authority in 2008.

² In view of the very limited number of published rulings on these issues, the assessments in this article are also based on the authors' own experience in their advisory practice, and on information received during informal consultations with competition authorities.

Carve-Out, before exploring the worldwide framework for Carve-Outs based on selected merger control regimes.³

The suspension obligation under merger control law and alternatives to a Carve-Out

The suspension obligation under merger control law prohibits the parties to a transaction from implementing the transaction until the competition authority has granted clearance (e.g. Sec. 41 (1) of the German Act Against Restraints of Competition, **ARC**). The provision applies invariably to all transactions even if the parties are based outside Germany.⁴ The purpose of the suspension obligation is to enable the competent national competition authority to assess in advance whether the transaction may have a negative impact on competition in the domestic market. Once the transaction is implemented, it will not always be possible to completely reverse all effects.⁵

Given the ever-increasing integration of global markets, many competition authorities are sceptical as to whether and how negative effects on domestic markets can be avoided in the event that a transaction is implemented abroad. This is one of the main reasons why they tend to be critical of Carve-Outs.⁶ Further, some competition authorities doubt the effectiveness of hold-separate arrangements because they believe that it will not be possible to completely unwind them.⁷

Depending on the circumstances in the individual case, the following alternatives to a Carve-Out may be worth considering:

- The suspension obligation does not apply to mere preparatory measures. The parties may therefore take legitimate steps to prepare for implementation immediately following

³ The authors do not address the question of how to respond to situations in which one or more competition authorities express competition concerns and the parties are consequently required to sell part of the transferred business to a third party before the transaction can be cleared. In preparation for such a sale, a carve-out with a hold-separate obligation may also be necessary, but the motivation and legal framework are very different, see, for instance, *Vormizeele*: NZKart 2016, pp. 459-466.

⁴ For Germany, cf. *Röhling*, in: Busche/Röhling, *Kölner Kommentar zum Kartellrecht (Cologne Commentary on Antitrust Law)*, 2014, Sec. 41 para. 33.

⁵ *Kallfaß*, in: Langen/Bunte, *Kartellrecht (Antitrust Law)*, 12th edn. 2014, Sec. 41 para. 1.

⁶ Cf., for instance, the German competition authority in the *Mars/Nutro* case (outlined on page 7).

⁷ For instance, the Brazilian competition authority, cf. <http://en.cade.gov.br/press-releases/cisco-and-technicolor-admit-practice-of-gun-jumping-in-global-transaction-1>.

receipt of the last clearance. They can, for example, identify potential synergies, establish integration plans and inform employees.⁸

- Moreover, if potential adverse financial consequences resulting from a delay take on exceptional proportions, more generous exemptions from the suspension obligation will generally be available. Many countries provide for exemptions from the suspension obligation if awaiting the competition authority's approval is likely to irreparably threaten, or at least seriously damage, the parties to the transaction, for instance if the target company is at risk of becoming insolvent.⁹ However, the financial loss must be exceptional and go beyond the consequences caused by the simple delay of implementation of the transaction due to the suspension obligation, such as lost profits or synergy gains.¹⁰
- Ultimately, in some cases, rather than applying for an exemption from the suspension obligation, it may be more promising to request faster clearance from the competition authorities. Being able to substantiate asserted negative economic repercussions (which do not reach exceptional proportions) may help.

Drafting provisions on the suspension obligation and a Carve-Out in the SPA

General provisions on suspension obligation

Given the suspension obligation, the SPA will typically contain a merger clearance clause. The standard content of such a clause is that the acquisition will not be closed until the relevant competition authority has either approved the transaction or granted an exemption from the suspension obligation (condition precedent). The clause will also usually stipulate the actions required to be taken by the respective parties to secure clearance. This is particularly relevant if the competition authorities are likely to have competition concerns and are, for instance, likely to be prepared to grant clearance only on the condition that parts of the acquired company are divested to a third party. In the (admittedly rare) event that a merger is blocked in its entirety, or if

⁸ *Mäger*, in: *Münchener Kommentar zum Kartellrecht (Munich Commentary on Antitrust Law)*, 2nd edn. 2015, Sec. 41 para. 9 with further references.

⁹ Cf., for instance, Sec. 41 (2) ARC or Art. 7(3) of the EU Merger Regulation, and *Bechtold/Bosch/Brinker: EU-Kartellrecht (EU Antitrust Law)*, 3rd edn. 2014, Art. 7 EU Merger Regulation, paras. 10 et seqq.; *Kellerbauer*, in: *Berg/Mäsch, Deutsches und Europäisches Kartellrecht (German and European Antitrust Law)*, 2nd edn. 2015, Art. 7 EU Merger Regulation, paras. 11 et seqq.

¹⁰ European Commission, 11 February 2011, COMP/M.5969 – *SCJ/Sara Lee*, para. 34.

the conditions for implementation have not been met by a particular date (long-stop date), the SPA typically also provides for a right to terminate the deal or even condition subsequent.¹¹ Sometimes, this is coupled with an obligation for the buyer to pay a so-called reverse break-up fee to the seller.

Providing for a Carve-Out

Besides the principles above, the SPA may provide that (the more significant) part of the transaction (i.e. certain parts of the business in certain jurisdictions) may be implemented if, for this specific part, (i) no clearances are required or the relevant clearances have already been issued and (ii) all other closing conditions have been met. By contrast, the remaining part of the transaction – relating to one or more jurisdictions of less significance – will be carved out until the clearance(s) in the relevant jurisdiction(s) have been issued.¹²

In order to implement this – not entirely straightforward – legal construct in the SPA, it is necessary first to specify the jurisdictions for which condition precedents related to merger clearance are required. The next step is to identify the specific jurisdictions for which merger control clearances must have been issued before a partial implementation of the transaction can be considered. In this context, it has to be clarified whether partial implementation is to be effected in the individual jurisdiction as soon as the relevant clearance is issued, or whether a certain threshold or minimum number of clearances for certain jurisdictions needs to be achieved. Given competition authorities' critical view of Carve-Outs, in particular in key merger control regimes, it may be advisable to specifically provide for partial implementation only if a certain minimum number of jurisdictions or the jurisdictions deemed particularly significant for the transaction have issued their approval.

By way of example, a provision could specify that: If on a particular date (X) merger control clearances have been granted in at least Y jurisdictions (Y being a specified number of jurisdictions which appears reasonable in view of the scope of the transaction) or in jurisdictions A, B and C (which are of key significance for the transaction as a whole) and the other (non-merger control-related) closing conditions have been met or waived, the transaction may be implemented in respect of these jurisdictions. In addition, the SPA may provide that the outstanding part of the overall transaction will be implemented when, with regard to the

¹¹ Cf. v. *Hoyenburg*, in: Rieder/Schütze/Weipert, Münchener Vertragshandbuch (*Munich Manual for Contract Law*), volume 2, Wirtschaftsrecht I (*Commercial Law I*), 7th edn. 2015, I. 5. note 101; Meyer-Sparenberg, in: Hoffmann-Becking/Gebele, Beck'sches Formularbuch Bürgerliches, Handels- und Wirtschaftsrecht (*Beck's Form Book for Civil, Trade and Commercial Law*), 12th edn. 2016, 16. Unternehmenskaufvertrag (*Share Purchase Agreement*), Sec. 4 (2).

¹² Cf. *Richter/Steinvorth*, in: Wiedemann, Kartellrecht (*Antitrust Law*), 3rd edn. 2016, Sec. 21 para. 54; Meyer-Sparenberg, in: Beck'sches M&A-Handbuch (*Beck's M&A Manual*), 2017, Sec. 43 para. 13.

remaining jurisdiction(s), merger clearance has been granted and the other closing conditions have been met or waived (deferred closing).

It will be essential to include a default provision to cover the situation where merger clearance is not granted and the merger is therefore prohibited in one or more jurisdictions. For instance, if merger control clearance has not been granted for jurisdiction A by date X, the SPA can be expressed to be capable of being terminated in respect of jurisdiction A. In addition, the SPA could provide that if merger clearances for at least Y jurisdictions or for jurisdictions A, B and C have not been issued by date X, the agreement will terminate in its entirety and in respect of all jurisdictions.

Provisions of this type, even though not uncommon, are certainly substantially more complex than the provisions contained in standard SPAs. Moreover, Carve-Outs are a feasible option only in a minority of merger control regimes. As a result, in practice, parties often opt not to include any provisions relating to Carve-Outs in the SPA, but rather choose to agree on further actions on an ad hoc basis, as and when they become relevant.

Overview of legal framework for Carve-Outs in merger control regimes worldwide

This section considers firstly selected merger control regimes which generally reject Carve-Outs. It then gives an overview of regimes which adopt a more liberal approach.

Regimes which generally do not accept Carve-Outs

Key competition authorities which regularly deal with (cross-border) transactions and have extensive experience in this regard generally reject Carve-Outs.

Germany

In principle, German law does not oppose Carve-Outs. Section 185 (2) ARC permits a transaction to be implemented abroad provided it will not have any impact on the domestic market.¹³

A very restrictive practice by the German competition authority, however, substantially limits the possibilities for Carve-Outs. The competition authority assesses the question of whether or not foreign implementation will have an impact in Germany based on extremely strict criteria.¹⁴ It is not sufficient simply to refrain from acquiring shares in German companies or assets located in

¹³ *Mäger*, in: *Münchener Kommentar zum Kartellrecht*, 2nd edn. 2015, Sec. 41 para. 20.

¹⁴ This has been criticised with regard to the principle of non-intervention under public international law, cf. *Rehbinder*, in: *Immenga/Mestmäcker, Wettbewerbsrecht (Competition Law)*, 5th edn. 2016, Sec. 130 paras. 113 et seqq. with further references.

Germany.¹⁵ Rather, the competition authority considers an impact on the German market to also be possible if the parts of the shares or assets acquired abroad are indirectly capable of improving the acquirer's position in Germany, for instance, because a key patent has been acquired or additional production capacities have been secured.¹⁶

This was precisely the situation when the U.S. animal food manufacturer *Nutro* was bought by *Mars* in 2008.¹⁷ *Mars* had secured merger clearance in the U.S., but the proceedings in Germany and Austria took significantly longer. *Mars* therefore decided to carve out *Nutro*'s German and Austrian activities and to implement the rest of the transaction. The German competition authority classified this conduct as gun jumping and imposed a fine of EUR 4.5 million on *Mars*. The competition authority reasoned that implementing the transaction outside Germany and Austria nonetheless had an impact on the German market because *Mars* had acquired the trademark rights and production facilities from *Nutro* in other countries. It considered these assets as decisive in order to secure a competitive advantage on the German market too. The remainder of the German proceedings did not run smoothly either: the competition authority raised competition concerns and *Mars* eventually abandoned the transaction in Germany.

European Union

The European Commission (**Commission**) adopts an even more restrictive stance on Carve-Outs than the German competition authority. Exemptions from the suspension obligation require a formal decision by the Commission (Art. 7(3) EU Merger Regulation). As can be seen from past cases, the Commission ultimately assesses Carve-Out requests against the criteria it uses to decide whether to grant an exemption in cases of exceptional financial harm.

In the context of the acquisition of *Dyno* by *Orica* in 2006, the Commission approved a Carve-Out, although it justified its decision with reference to the exceptionally serious consequences to be expected if the transaction were to be further delayed. Moreover, the Commission was of the opinion that the Carve-Out of the target's business located outside Europe would not have impeded any measures to eliminate competition problems in Europe.¹⁸

¹⁵ *Dietze/Janssen: Kartellrecht in der anwaltlichen Praxis (Antitrust Law for Lawyers in Practice)*, 5th edn. 2015, para. 951. In 1989, the German competition authority accepted a Carve-Out which consisted of a simple separation of the company holding the German business (decision of 3 March 1989, WuW/E BKartA 2363 – *Linde/Lansing*) – today, however, a similar solution might not be accepted by the competition authority.

¹⁶ *Richter/Steinvorth*, in: *Wiedemann, Kartellrecht*, 3rd edn. 2016, Sec. 21 para. 54. Moreover, the impact in Germany must also be "appreciable", cf. *Mäger*, in: *Münchener Kommentar zum Kartellrecht*, 2nd edn. 2015, Sec. 41 GWB para. 20; *Bechtold/Bosch: GWB*, 8th edn. 2015, Sec. 130 para. 22.

¹⁷ In this regard and in respect of the following paragraphs, see press release issued on 15 December 2008 "Fine imposed against Mars for violating the prohibition to put a merger into effect".

¹⁸ European Commission, 11 April 2006, COMP/M.4151 – *Orica/Dyno*.

By contrast, in 2011, the Commission rejected an application filed by *SC Johnson* to acquire the non-European part of *Sara Lee's* domestic insect control business prior to the implementation of the rest of the transaction. In the Commission's opinion, *SC Johnson* had failed to prove that the negative financial effects caused by the delay would have exceeded the consequences normally caused by the suspension obligation during the merger control procedure. Furthermore, according to the Commission, *SC Johnson* had not sufficiently clearly distinguished in the application between the business within and outside Europe.¹⁹

Brazil

The regime in Brazil is similarly strict. Although no express regulations governing Carve-Outs exist, the Brazilian competition authority has repeatedly stated that it adopts a restrictive stance. In a speech in 2012, the head of the Brazilian competition authority confirmed that, as a general rule, Carve-Outs would be rejected. In 2016, the competition authority imposed the highest worldwide fine to date, the equivalent of EUR 6.7 million, for a Carve-Out which it regarded as gun jumping.²⁰

Cisco Systems and *Technicolor* had implemented the global part of the transaction in question while agreeing a Carve-Out with regard to the Brazilian part. The competition authority ruled, however, that the Brazilian part of the business had not been sufficiently isolated, arguing, in particular, that the markets affected by the transaction were international (as the parties themselves had stated in their notification).

However, local counsel takes the view that the Brazilian competition authority's arguments could potentially be interpreted to allow a Carve-Out if the parties are able to show that the deal will not have any impact on the domestic market.

China

China ranks among the strictest regimes worldwide. There are no regulations specifically governing Carve-Outs, but in informal consultations the competition authority has expressly communicated that, in general, it will not accept them. The Chinese competition authority has even in a case of impending insolvency of the target company denied an exemption from the suspension obligation.

U.S.

The U.S. authorities also generally reject Carve-Outs in cases in which the transaction in question is required to be notified in the U.S. Local counsel considers that Carve-Outs may be accepted only if a transaction does not have to be notified in the U.S., but is nevertheless picked

¹⁹ European Commission, 11 February 2011, COMP/M.5969 – *SCJ/Sara Lee*.

²⁰ In this regard and in respect of the following paragraphs, see the press release issued by the competition authority, available at: <http://en.cade.gov.br/press-releases/cisco-and-technicolor-admit-practice-of-gun-jumping-in-global-transaction-1>.

up and scrutinised by the competition authorities, for example in response to complaints from US customers.

Regimes which are more open to Carve-Outs

As the following selection shows, a number of competition authorities are more liberal in the face of Carve-Outs.

Colombia

The situation in Colombia is unique because express regulations governing Carve-Outs exist. These regulations permit a Carve-Out if (i) the buyer is not able to control nor influence the Colombian business of the target company, (ii) business secrets relating to the Colombian business of the target company are shielded from the buyer, and (iii) the Carve-Out is structured so as to ensure that, should the Colombian competition authority prohibit the transaction, the Colombian business could easily be reintegrated in the seller's business. Conceptually, these preconditions reflect the purpose of the suspension obligation described above: the competition authority is able to thoroughly assess the transaction before an irreversible situation is created, so that in the event that clearance is refused the transaction can be reversed.

The Carve-Out exemption is applicable by law, i.e. no formal exemption by the competition authority is required. The parties do, however, have the option of applying for a formal exemption. The competition authority is required to issue a decision on any such application within five days.

South Africa

Carve-Outs are also common practice in South Africa.²¹

The precedent appears to have been set in relation to the merger between *A.P. Møller-Mærsk* and *Royal P&O Nedlloyd* in 2005. This merger was implemented early in Europe while the South African part was carved out for the duration of the South African proceedings and implemented separately at a later date.

India

Carve-Outs of the national part of a transaction may also be an option in India.

For instance, the Indian competition authority apparently accepted this approach in the *Holcim/Lafarge* merger. The deal was implemented at a global level before clearance had been issued in India.²²

²¹ *Legh/Dini: Merger Control South Africa*, in: *Getting The Deal Through*, September 2017.

²² Case C-2014/07/190, available at http://www.cci.gov.in/sites/default/files/C-2014-07-190_0.pdf.

In contrast, the Indian competition authority rejected a Carve-Out in two other cases (*Baxter/Baxalta* and *Eli Lilly/Novartis*).²³ It identified a breach of the suspension obligation because the global (framework) agreement had been implemented before the notification relating to the Indian business (in respect of which the parties had entered into a separate (sub-) agreement in both cases) had even been submitted in India.

Conclusion

Parties in cross-border corporate transactions will often be left with no other option than to implement the entire transaction only once all required merger control clearances have been obtained. Many countries have restrictive statutory regulations or decision practices and the consequences in terms of liability in the event that an infringement of the suspension obligation is identified may be substantial. Nevertheless, there will be cases in which it is important for the parties that a transaction be completed by a particular date and in which, for instance, only one or a few clearances in countries of only minor economic significance for the transaction overall are outstanding. If these countries include a jurisdiction which generally permits a Carve-Out, this could present a realistic solution. As regards the SPA, the Carve-Out provisions must be worded with appropriate care in order to be able to partly implement the transaction and to further minimise any remaining risks.

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²³ Case C-2015/07/297, available at: <http://www.cci.gov.in/sites/default/files/faq/Order%20under%20Section%2043A-297.pdf>, and case C-2015/07/289, available at: http://www.cci.gov.in/sites/default/files/Notice_order_document/Order%20us_43A.pdf.