The impact of COVID-19

MERGER CONTROL IN TIMES OF CRISIS

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INTRODUCTION

While some businesses may choose to delay transactions in light of Covid-19, many transactions will clearly continue and some of these will need to be completed with some urgency, in particular in cases of financial distress.

Merger control regimes are still in operation, although there have been some changes, in particular to encourage parties to delay notifications, and in some cases, merger control authorities have temporarily closed (see further our recent updates covering the impact of Covid-19 on competition law and merger control in the UK and EU, Asia and Australia).

This note considers how merger control processes can best be navigated in times of crisis, for example, where the urgent completion of a transaction may be required, or the target is otherwise in significant financial difficulty.

**KEY POINTS**

- In most merger control regimes, there is a prohibition on completing transactions before clearance has been received, and significant fines and other penalties may be imposed for "gun jumping". In these jurisdictions, parties looking to complete urgent transactions might consider seeking derogations from the standstill obligations (where available), or in certain circumstances could consider deal structures which avoid triggering merger control.

- In so-called voluntary regimes, there is no similar restriction, although complications may arise in these jurisdictions from completing notifiable transactions before obtaining clearance, such as "hold separate" orders requiring the merged businesses to be operated independently and the risk that the transaction may ultimately have to be unravelled.

- Where notifications are made, parties might consider whether 'failing firm' or weakened competitor arguments would apply, although these are interpreted strictly by regulators.

- Parties will also need to consider the impact of foreign investment regimes. Covid-19 has prompted some jurisdictions to focus even more closely on such controls as they seek to protect against strategic assets falling into the hands of foreign entities over which they may have less influence.

**THE GENERAL MERGER CONTROL POSITION**

The majority of merger control regimes globally, including the EU Merger Regulation ("EUMR"), the US and China, impose a strict prohibition on completing a notifiable merger before clearance has been granted. In such jurisdictions, fines may be imposed for early completion or for taking steps to start integrating the merged businesses before clearance has been granted (known as "jumping the gun").

However, some jurisdictions, for example, the UK, Australia and Singapore, operate so-called "voluntary" regimes. In these jurisdictions, the transaction may lawfully be completed prior to securing merger clearance. It is therefore possible to exchange and complete simultaneously, prior to merger clearance being granted. However, there are complications in doing so, including:

- In the UK, the Competition and Markets Authority ("CMA") will invariably impose a "hold separate"/initial enforcement order if it reviews a transaction which has already completed (whether following notification or having identified the transaction through its mergers intelligence function). The effects of this are considered further below;

- In Australia, the Australian Competition and Consumer Commission ("ACCC") can bring proceedings and seek orders from the Federal Court, such as an injunction to prevent a transaction from completing or, in the case of a completed transaction, the imposition of fines and divestment of shares or assets, if the transaction is likely to have the effect of substantially lessening competition in any market in Australia; and
• in Singapore, the Competition and Consumer Commission of Singapore ("CCCS") will not hesitate to impose interim measures directions (to prevent the merger from completing or on completion to prevent the parties from exercising their rights under the merger) until it has completed its investigation.

MANDATORY MERGER CONTROL REGIMES

The majority of jurisdictions have merger control regimes which require mandatory pre-completion notification and clearance. As notification and clearance will take a minimum of several weeks in most jurisdictions (and sometimes considerably longer), the necessity of making a mandatory filing and waiting for clearance before closing may present significant difficulties for transactions which need to complete urgently.

However, there are a number of ways in which the delay between exchange and completion can potentially be avoided, or at least reduced. We focus below on the EUMR, but similar mechanisms (or some of them) are also available under other regimes.

In particular, a derogation can be sought from the obligation not to complete the transaction prior to clearance in the EU. Alternatively, it may be possible to structure the transaction so that control (for merger control purposes) does not arise.

Derogation from the suspensory requirement

Under the EUMR, it is possible to apply to the European Commission for a derogation from the obligation not to close a transaction prior to obtaining clearance (for more information on the EUMR merger control regime see our Quickguide). It is also possible to apply for similar derogations/exemptions under the merger control regimes of a number of the EU Member States (including Germany, France and Spain) as well as in other jurisdictions including Brazil.

In order to receive a derogation under the EUMR, the transaction must satisfy two conditions:

• no negative effect on competition; and
• the threat of serious damage for the parties or third parties if no derogation is granted.

As regards the first condition, the Commission will typically only grant derogations in cases where it can clearly determine that there is no prospect of a negative effect on competition, i.e. where the parties can demonstrate there are no, or only very minor, overlaps in their competitive activities.

With respect to the second condition, financial distress is a common ground for seeking a derogation. Derogations have in the past been granted where there has been a high risk of insolvency occurring within the timescale of the usual EUMR process. For example, during the 2008 financial crisis, derogations were granted for the acquisition by Santander of Bradford & Bingley's retail deposits business (and related assets) and the acquisition of Fortis by BNP Paribas.

Some of these derogations were granted extremely rapidly. For example, the Bradford & Bingley derogation was granted in less than 24 hours of receipt of the formal application. However, this was to a significant extent driven by the fact that the application was actively supported by the UK Government on the grounds, which the Commission accepted, that the financial failure of Bradford & Bingley would likely have had an adverse impact on the stability of the financial system as a whole. Most struggling businesses are of course unlikely to be able to call on such arguments.

Just over 40 transactions have been granted derogations from the standstill obligation under the EUMR since its adoption in 1990.

In terms of process, a relatively detailed submission setting out why a derogation is appropriate needs to be made. As noted above, the Commission can act very quickly in granting a derogation if needed. However, typically the Commission will require at least a few working days in which to consider the application and the parties may need to provide further information.

As the Commission frequently grants clearance in straightforward cases within 16-18 working days, parties need to consider on a case-by-case basis whether it would be better to seek a derogation or
simply to try to expedite the merger review process. Certainly, experience suggests that in most cases, the Commission's preference will be to try to get through the merger approval process quickly rather than going through a derogation application process (as well as the normal merger clearance process). Amongst other things, this will depend on whether it is likely that the target business will be able to continue functioning for the duration of the typical EUMR process. As noted above, an EUMR clearance can be obtained within 16 working days of formal application in straightforward cases, but the time to draft the EUMR notification form and generally to engage in pre-notification discussions with the Commission also needs to be factored in.

If a derogation is granted, it will typically be subject to a number of conditions. In particular:

- the derogation is not an exemption and parties must typically agree a time period within which a notification will be made, although this may be after completion;
- the derogation will generally be limited to the minimum amount of control that is required in order to avoid the threat of serious damage. For example, the acquirer may be permitted to complete the transaction and take related actions (e.g. to secure financing), but is unlikely to be permitted to take general strategic control until the actual clearance has been obtained.

**Structuring the transaction to avoid an acquisition of control**

It may be possible to structure the transaction so that control (for merger control purposes) does not arise.

For example, under the EUMR, in circumstances where at least three parties each hold minority shareholdings in a target company, and none of them individually has veto rights over key strategic decisions (such as the appointment of senior management, or the approval of the annual budget and business plan) or a shareholding sufficiently large to amount to sole control in practice, a situation of no overall control (or "shifting allegiances") may arise. In this scenario, as there is no acquisition of control (whether sole or joint), the transaction would not require notification.

Whilst shifting allegiance structures have been successfully deployed before the European Commission in many cases, they require careful drafting in order to avoid the Commission finding that one or more parties has in fact acquired control. In particular, the Commission may subject the arrangements to particular scrutiny where the parties attempt, at a later stage, to alter the structure of the transaction to acquire the protection of strategic vetoes. If the Commission determines that this was the purpose from the outset and that the two steps in fact formed part of a single transaction, it may consider that a notification obligation arose at the first stage.

In other jurisdictions, informal advice from the State Administration for Market Regulation ("SAMR") and its predecessor suggests that shifting allegiances structures are also recognised in China. Adopting such a structure (and so avoiding triggering merger notification requirements) can be of particular benefit in the context of auction processes, where sellers may prefer bidders who trigger fewer filing requirements.

In some instances, an alternative approach may be for the proposed transaction to be structured in two stages or to defer the acquisition of control by using option structures. However, **such structures should not be entered into lightly**. As suggested above, the Commission (and other regulators) may view two-stage transactions as parts of a single transaction, rather than as two separate transactions. In that event, the obligation not to complete the transaction before clearance would apply to both parts of the transaction, not only to the second part.

Importantly, the Commission has the power to impose very significant fines for implementing a notifiable transaction without first obtaining clearance. For example, in 2019, a €28 million fine was imposed on Canon in circumstances where it used a two-stage structure involving options to acquire control of Toshiba Medical Systems, only applying for clearance at the stage that it wanted to exercise its options. Canon was also fined in other jurisdictions, including the US and China.
VOLUNTARY MERGER CONTROL REGIMES

While there is no equivalent standstill obligation in voluntary merger control regimes, so that transactions may legitimately complete before clearance is granted, there remain a number of complexities which can impact on urgent transactions. We consider some of these below.

The UK

As mentioned above, the UK regime is voluntary and therefore does not require transactions to be notified and cleared before they can be completed (for more information on the UK merger control regime see our Quickguide). However, the CMA will invariably impose a “hold separate” order/initial enforcement order (“IEO”) on any completed transaction which it investigates. An IEO freezes any further integration of a completed merger, and may even require that any integration which has already taken place be reversed (in rare cases, an IEO may also be imposed on anticipated mergers, potentially preventing completion prior to clearance). The order will require that the two businesses are managed as two separate entities. Standard provisions in an IEO include restrictions relating to:

• Appointing directors or other staff of the buyer to the Board or other management positions of the target.
• Seconding employees to the target from the buyer.
• Integrating the businesses of the buyer and the target, including as regards assets, employees, marketing, sales etc.
• The buyer ensuring that there are sufficient financial and other resources available to the target so that it can carry out its pre-merger business plans.
• The buyer engaging in the target’s strategic decision-making.
• The buyer viewing competitively sensitively information of the target.

It is possible to agree derogations from the standard IEO to permit limited actions (subject to safeguards) but these take time to negotiate and agree with the CMA. In practice, it is recommended that parties engage with the CMA as early as possible (and ideally prior to completion) so that essential derogations can be agreed in advance.

It should also be noted that an acquirer which completes a transaction without obtaining CMA clearance is accepting the risk that the CMA may decide that the transaction is problematic and ultimately require remedies (e.g. divestments) to resolve its concerns, or in rare cases the whole target business to be divested.

Australia

The regime in Australia is also voluntary and there is therefore no legal requirement for transactions to be cleared before they can be completed. However, the ACCC can seek an urgent injunction to prevent a transaction completing until it has had sufficient time to investigate it thoroughly. As noted above, fines may also be imposed if completed transactions are thought likely to have the effect of substantially lessening competition.

Currently, the ACCC continues to accept new requests for merger clearance and anticipates that the timing of its clearance decisions will generally be in line with its usual guidance. The ACCC may also be prepared to review some transactions on an expedited basis.

Singapore

While the regime in Singapore is also voluntary, if a merger substantially lessens competition, the CCCS can impose substantial fines of up to 10% of the Singapore turnover for each year of infringement, up to a maximum of 3 years. As with other voluntary regimes, directions to remedy, mitigate or eliminate the adverse effects arising from the merger may also be issued. In addition, interim measures may be ordered to block anticipated mergers temporarily.
SUBSTANTIVE MERGER CONTROL ISSUES RELEVANT TO DISTRESSED TARGETS

In the context of transactions involving distressed targets, there are two particular issues which merit consideration where the acquirer has significant overlapping businesses with those of the target (and therefore neither a speedy clearance, nor a derogation from the suspensory obligation under the EU Merger Regulation is likely to be available), namely:

- the “failing firm” defence; and
- a weakened competitor, or “flailing firm” argument.

The “failing firm” defence is in principle accepted by many competition authorities globally.

In broad terms, where one of the parties to a transaction is failing and will exit the market in the absence of the transaction, this reduction in the number of competitors should not be attributed to the transaction. Rather, the assessment of the effect of the transaction on competition should be assessed by reference to a world in which the restructured business did not exist as an independent entity.

Whilst this argument may appear attractive in the current environment, it effectively requires the parties to concede that the transaction may have anti-competitive effects, which is not often appealing.

Moreover, there are generally strict conditions for the application of the failing firm defence, the satisfaction of which will need to be demonstrated to the regulator on the basis of compelling evidence. It will likely be necessary to establish that:

- absent the merger, the company (and its business/assets) would inevitably have exited the market in the near future and there is no serious prospect of a successful re-organisation; and
- there is no less anti-competitive alternative to the transaction, such as the purchase of the failing firm (or its core assets) by an alternative buyer which raises fewer competition concerns or, potentially, the firm exiting and remaining players competing for its market share rather than all of its market share transferring to one competitor.

Regulators are typically strict in their application of failing firm arguments. In many cases, the application of these arguments is rejected (including where a company enters into administration), often because the regulator concludes that there are alternative, less anti-competitive purchasers. It should also not be assumed that the current situation will make the defence easier to substantiate. For example, the ACCC has made it clear that it will “look through” the current market conditions. This means that the ACCC will take into account not only the current financial situation but also the longer term impact on competition of changes in market structures. This is understood to mean that current financial distress caused by COVID-19 is unlikely to be viewed by the ACCC as sufficient on its own to support failing firm arguments. The CMA has also confirmed that the failing firm defence will continue to be assessed in the same way during COVID-19, with no relaxation of evidential standards.

Nevertheless, the failing firm defence has been accepted in some cases and this is also beginning to happen in the context of COVID-19. On 17 April 2020, the CMA announced in the context of its detailed Phase 2 investigation into the acquisition by Amazon of a minority stake in Deliveroo that it had provisionally found that the transaction was not expected to result in a substantial lessening of competition. This followed the CMA's December 2019 Phase 1 decision that the transaction merited a detailed investigation due to the risks it posed to competition. Specifically, the CMA has provisionally concluded that, in light of COVID-19 and the resulting impact on Deliveroo's revenues, Deliveroo is likely to exit the market without receiving the additional funding available from Amazon through the acquisition, that no less anti-competitive investor than Amazon is likely to be available, and that Deliveroo’s exit would be more detrimental to customers and competition than the transaction. The CMA is aiming to reach its final decision by the end of May 2020.

Other previous examples of the failing firm defence being applied include by the European Commission in Aegean Airlines/Olympic Air II (M.6796) in 2013 and the CMA in Aer Lingus/Cityjet in 2018.

The concept of the “flailing firm” defence is based on the fact that regulators will typically be required to assess future competition in the marketplace by reference to historic data. The flailing firm
argument applies where, although not in imminent danger of collapse or market exit absent the transaction, one of the parties has recently been weakened and thus its historic market share may overstate its current and future competitiveness.

Again, the success of this argument is likely to be based on the availability of compelling evidence as to the future competitiveness of the company in question and its prospects for successful reorganisation and rejuvenation. In this regard, the fact that the current crisis is generally seen as likely to be temporary means that liquidity issues caused by COVID-19 are unlikely to be seen as justifying a permanent change to the market structure which may be anti-competitive.

For more information on substantive analysis in merger control reviews, see our Quickguide.

THE GROWING IMPORTANCE OF FOREIGN INVESTMENT REGIMES

In addition to the need to secure merger clearance, many jurisdictions have foreign investment regimes. There has been a trend in recent years for countries (and the EU) either to introduce foreign investment regimes for the first time, or to strengthen their regimes. This reflects a concern to ensure that strategic assets and critical national infrastructure do not fall into the hands of undesirable foreign owners, or more generally to ensure that countries do not become overly dependent on foreign entities, including state-owned entities.

In the context of the Covid-19 crisis, there has been increasing focus on these regimes as countries seek to protect their healthcare assets and infrastructure. For example, the EU has urged its Member States to make full use of national foreign investment regimes in the case of acquisitions that could pose a risk to critical health infrastructures and the supply of critical inputs. Similarly, the Australian Government has reduced the monetary threshold for mandatory notification of transactions to the Foreign Investment Review Board to A$0, meaning that many more transactions will need to be notified. The timetable for FIRB decisions has also been extended to 6 months.

An uptick in interventions against acquisitions by foreign entities, particularly but not only in the healthcare sector, therefore seems likely in the coming weeks and months. Where relevant, this will need to be factored into deal timetables.

Please do not hesitate to contact any member of the Ashurst Competition team if you have questions in relation to any of the issues considered above. A list of key contacts is overleaf.
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