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Getting The Deal Through

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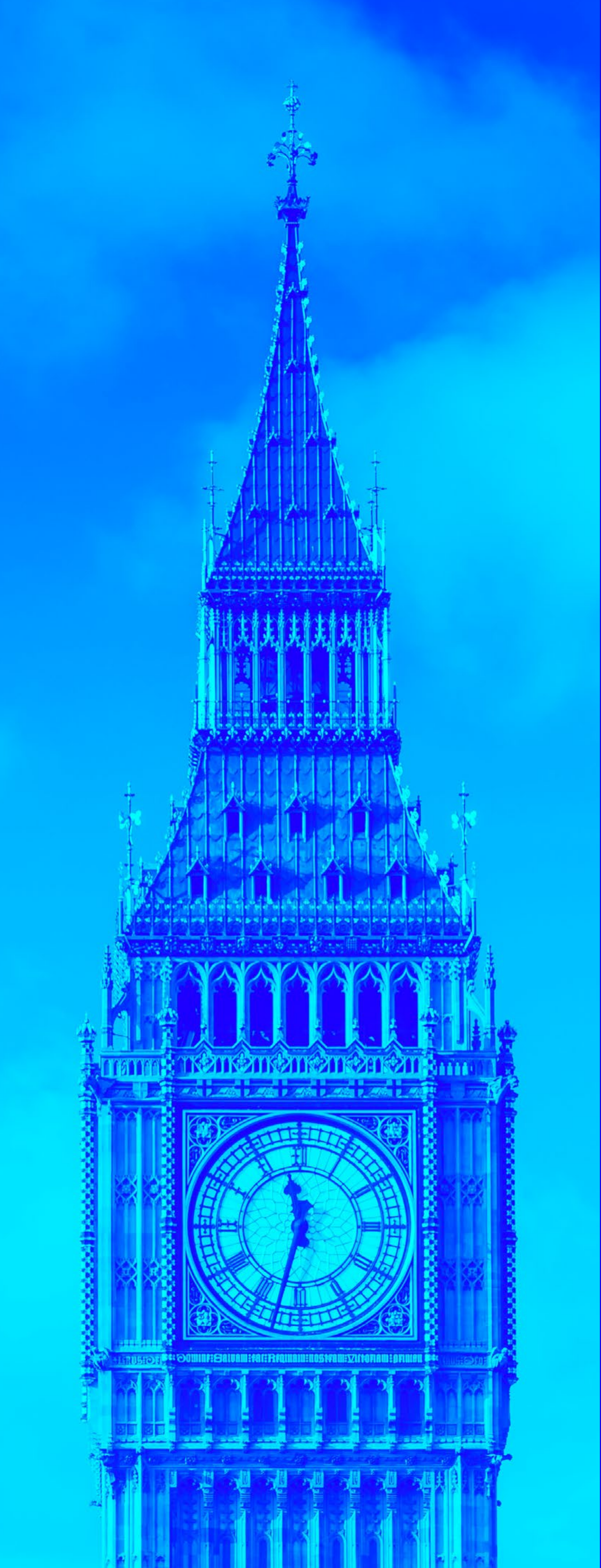

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Regulatory roadblocks to private M&A transactions: navigating competition, foreign direct investment and foreign subsidies controls

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Identifying regulatory obstacles to cross-border transactions and designing strategies to secure clearances is becoming an ever more challenging task for transacting parties. There are now more than 130 jurisdictions worldwide with active merger control regimes. Antitrust regulators, notably the UK Competition and Markets Authority (CMA) and the European Commission (EC), have also adapted their jurisdictional tests to allow for the discretionary 'call-in' of deals that would have previously avoided scrutiny, including in matters where a target has little or no local revenues.

In addition, a growing number of jurisdictions, particularly in Europe, have adopted foreign direct investment (FDI) screening mechanisms to assess whether various transactions raise broader national security or other 'public interest' concerns. For example, from 2022 to 2023, the UK government reviewed 766 deals that were notified and called in 10 non-notified deals for review. To add a further layer of complexity to regulatory risk assessments, the EU's Foreign Subsidies Regulation (FSR) has now also come into force, giving the EC far-reaching powers to investigate any market situation where it suspects non-EU subsidies are distorting competition.

Each category of regulatory regime has a number of critical features that should be a focus for dealmakers at an early stage in deal planning, to mitigate adverse timing and other execution risks. Knowing and planning for regulatory risks from the outset increases the chances that reviews can be avoided or that their burdens can be minimised.

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Global merger control

In contrast to relatively young FDI regimes and the new EU FSR regime, deal teams will be familiar with merger control reviews, which have been established for some time in most jurisdictions. However, outcomes are becoming less certain, as regulators continue to expand their jurisdictional reach, seek to correct perceived historic under-enforcement and consider novel theories of harm, including taking action to prevent the loss of nascent competition ('killer acquisitions').

Wider jurisdictional reach

Article 22 of the European Union Merger Regulation

In contrast to the CMA, the EC did not historically call in deals for review that fell below the applicable financial thresholds. Under its revised approach to article 22 of the EU Merger Regulation (EUMR), however, the EC is actively investigating deals, despite applicable financial (revenue) notification thresholds not being met. However, it is only able to do so on referral from a national antitrust authority at the EU member state level. Such referrals are becoming more common, and the EC is now routinely exercising this power in relation to deals in strategic industries; notably pharmaceuticals, high-tech and raw materials. These requests are often burdensome to address and can create considerable deal timing uncertainty. For transactions where there is a high risk of referral, it is therefore advisable to proactively brief the EC to avoid uncertainty and adverse timing implications at a later stage in the deal timeline.

Where parties do not fully comply with an EC requirement to suspend closing, pending the outcome of an investigation, sanctions may also be severe. On 12 July 2023, the EC imposed the maximum gun jumping fine of 10 per cent of the acquirer's global turnover (in that case, €432 million) for closing the deal during an ongoing merger control review that had been initiated under article 22 of the EUMR.

While this was the first, it is not likely to be the last example. Both the CMA and the EC have active merger intelligence teams and routinely send information requests to companies engaged in transactions in strategic industries (eg, pharmaceuticals, high-tech and raw materials) that would not otherwise be notifiable.

Finally, following a recent judgment rendered by the European Court of Justice, parties should also be aware that where a deal does not trigger merger control filings either at the EU or member state level, and the deal has not been referred to the EC pursuant to article 22, it may still be investigated under EU abuse of dominance rules for the strengthening of a dominant position through an acquisition in a way that would substantially impede competition.

Digital markets regulation

In line with the widened jurisdictional reach of the EC, the powers of the CMA are also likely to be significantly broadened in the near future. Pursuant to the Digital Markets, Competition and Consumers Bill (the Bill) published on 25 April 2023, a new jurisdictional filing threshold will be introduced, which can be met if one party alone has a share of supply of at least 33 per cent and a UK turnover exceeding £350 million, as long as the other party has a UK nexus (eg, subsidiary or customers). The intent behind this additional threshold is to analyse acquisitions of nascent competitors by well-established players that could reinforce their market position.

The Bill will also give the CMA's newly established Digital Markets Unit the power to classify companies with 'Strategic Market Status' (SMS). Unlike the voluntary merger control regime that applies to all other companies, companies with SMS will be subject to a mandatory filing requirement where they acquire at least 15 per cent of a target with a UK nexus for a consideration of £25 million or more. These legislative initiatives demonstrate the continued focus of antitrust regulators on rigorous enforcement in digital markets.

The CMA is not alone in specifically regulating the digital markets space. In November 2022, the EC's Digital Markets Act (the DMA) entered into force, creating a tailored regulatory regime for large tech companies. Similar to the SMS designation, the DMA allows the EC to designate companies as 'gatekeepers' from May 2023. The gatekeeper status imposes certain antitrust compliance obligations on large tech companies, designed to pre-emptively tackle unfair business practices. Notably, gatekeepers are subject to special merger control notification requirements; they must submit a merger control filing to the EC relating to any transactions where the parties provide core platform services, any other services in the digital sector or services that enable the collection of data. The merger filing form itself also deviates from the standard one submitted by other transacting parties.

Increased divergence among regulators

With the UK formally leaving the EU, the CMA is now able to review transactions that would have previously fallen within the exclusive jurisdiction of the EC. As a consequence, transacting parties are now engaging in parallel review processes in London and Brussels with meaningful risk of divergent outcomes. For example, the EC conditionally approved Microsoft's US$68.7 billion acquisition of Activision Blizzard a month after the CMA – rejecting remedies similar to those accepted by the EC – blocked the deal altogether. This is only one in a recent string of cases evidencing an emerging trend of EU-UK regulatory divergence in the post-Brexit era. At the start of 2022, the EC conditionally cleared Meta's US$1 billion acquisition of Kustomer, after the CMA had unconditionally cleared the deal four months prior. Later that year, in March 2022, the CMA blocked the US$5 billion Cargotec/Konecranes merger, only a month after the EC had cleared the deal subject to remedies.

While regulators routinely request confidentiality waivers to allow them to engage with their counterparts running parallel reviews, this does not guarantee consistent approaches across jurisdictions. US regulators are willing to pursue a broad range of theories of harm but have had relatively little recent success litigating to block deals. And, as illustrated above, the CMA is also willing to chart its own course and block deals that have been conditionally approved in Brussels or Washington. Notwithstanding the above, it should be noted that there are also (albeit limited) cases of convergence. For example, the proposed amendments to the US Hart-Scott-Rodino Antitrust Improvements Act will make it more akin to the EU merger control filing form (the Form CO), expanding on the information that parties will be required to produce.

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Considering the above, well-advised companies should design regulatory engagement strategies to look across borders and take account of the various different analytical approaches applied by regulators in major jurisdictions, in order to minimise deal risk.

Willingness to block deals

There is a growing trend of a stricter approach to merger control remedies. In recent cases, the CMA has shown a preference to block deals in favour of accepting remedies to address identified competition law concerns. Similarly, in the United States, the Federal Trade Commission and Department of Justice have shown a higher degree of willingness to block deals, as they have grown increasingly sceptical of remedies. The burden on the parties to convince regulators that a proposed remedy package will adequately address any competition law concerns is therefore heavier than it used to be. In complex deals, it is advisable for parties to consider remedy packages at an early stage and proactively offer these up to the regulators.

Global foreign direct investment

For more than 30 years, the Committee on Foreign Investment in the US has been able to block acquisitions that threaten defence or other critical national interests. In recent years, similar regimes have proliferated across the world. Currently, all G7 countries have operational FDI regimes. So do 22 of the 27 EU member states.

As with merger control review, there is no 'one-size-fits-all' approach when looking at different FDI regimes. Jurisdictions (particularly outside the EU) have taken divergent approaches in seeking to protect their own interests through a variety of mechanisms.

Notification obligation

Sectoral coverage

One of the major variances between FDI regimes lies in their sectoral coverage. Most jurisdictions take a focused approach, identifying (albeit broadly) particularly sensitive sectors within which foreign investments may be subject to review. Crucially, it is not just about national defence. Typically, in addition to defence, this will include categories such as critical infrastructure and critical technology, as well as other sectors potentially sensitive to the jurisdictions in question (eg, telecommunications). Certainly, in the UK, data infrastructure, artificial intelligence and advanced materials have attracted scrutiny alongside the sectors more traditionally viewed as 'sensitive' (eg, defence, military and dual-use). Other jurisdictions (including the Australian, Canadian, German and UK voluntary notification regimes) do not limit their powers according to relevant sectors.

Investor identity

Whilst some investors' home states may be perceived as potentially more threatening to the UK than others, this will generally tend to affect the outcome of the screening, rather than determine which transactions are caught by the initial filing obligation.

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Transaction structure

A number of factors in the structure of the target and transaction may impact the obligation to notify. Typically, a filing can be excluded in jurisdictions where the transaction does not involve the indirect acquisition of a local subsidiary. However, in Japan, South Korea and Taiwan, for example, only direct acquisitions of an interest in a domestic company are covered.

One notable exception to this general rule is the UK, whose FDI screening regime covers transactions where the target supplies goods or services to customers located in the UK or otherwise 'carries out activities in the UK', irrespective of the existence of a local subsidiary.

Another factor that drives the early FDI risk assessment is the level of control of the target company being acquired. In many jurisdictions, a transaction will not be subject to review if no control is being acquired or if the equity acquired is below a certain threshold (eg, 10 per cent in Spain, 25 per cent in the UK and 49 per cent in Mexico).

Furthermore, jurisdictions such as the UK may also, in certain circumstances, carry out reviews of not only traditional M&A deals but also a range of other transactions, including internal reorganisations, grants of licence agreements, lending transactions and appointments of liquidators or receivers.

Early consideration of these issues may, depending on the circumstances, allow the parties to adjust the transaction structure to avoid triggering FDI notification obligations.

Substantive assessment

Unlike merger control reviews, where antitrust regulators will communicate 'theories of harm' identified to the parties, FDI review processes are more opaque. For example, in the UK, parties should not expect regular status updates during reviews. The identity of the case team and other government departments engaged in the review is also typically not disclosed. If they are disclosed, direct access will be limited (with correspondence taking place via a generic email address).

In the majority of cases, the activities of the target will be the primary driver of the FDI assessment. However, there are certain categories of acquirers that are viewed as problematic. For instance, in the UK, there has been a clear focus on acquirers with actual or potential links to China and Russia (which accounted for all publicly known prohibition decisions in 2022). That said, acquirers domiciled elsewhere were not immune from close scrutiny; in 2022, remedies were also imposed in deals involving acquirers from the United Arab Emirates, the US and the UK.

In contrast to antitrust regulators, FDI regulators are more willing to impose non-structural, behavioural remedies. These may include keeping certain strategic capabilities within the country; with information restrictions, security measures and government oversight through the approval of board members, auditors and security officers.

Sanctions

The consequences for failure to comply with an obligation to notify are typically severe, and include both civil and criminal sanctions. Civil penalties will often include a fine that, in India and Spain for example, can be as large as the entire transaction value. In addition, most regimes have the power to require the parties to unwind the transaction pending approval, while certain others have the ability to impose criminal sanctions (eg, individuals responsible for a failure to notify in the UK may be imprisoned for up to five years and in Australia for up to three years). In some jurisdictions, such as the UK, a failure to notify may also result in director disqualification. It is therefore important that dealmakers carry out extensive due diligence and take compliance seriously.

UK National Security and Investment Act 2021

In the UK, a standalone foreign investment regime became fully operational on 4 January 2022 under the National Security and Investment Act 2021 (the NSIA). The NSIA was initially enforced by the Investment Security Unit (ISU) of the Department for Business, Energy and Industrial Strategy. However, about a year after the regime went live, the UK government moved the ISU to sit within the Cabinet Office.

The NSIA establishes a dual mandatory and voluntary notification regime. The mandatory regime requires notifications where the target is active in one or more of the 17 broadly defined 'sensitive sectors of the economy' (eg, artificial intelligence, communications, defence, military and dual-use). The NSIA prohibition and remedies cases to date demonstrate that the ISU is closely scrutinising a range of sectors. In addition to the obvious categories of military, dual-use and defence, the ISU has blocked or imposed conditions in a range of other sectors, including communications (four cases), energy (three cases), computing hardware (three cases), advanced materials (three cases), and space and satellite technology (two cases).

The NSIA also gives the ISU discretion to call in transactions across any sector under the voluntary notification regime where it deems that the deal may pose 'UK national security concerns' – a term that is not defined. Notably, even under the voluntary regime, the ISU has demonstrated a willingness to impose restrictive interim orders, pending the outcome of its review. These may impose restrictions that go even further than the standstill obligation under the mandatory regime and prohibit any communications between the parties altogether.

Where national security concerns are identified, remedies are not negotiated with the parties, though parties do have an opportunity to make written representations. Once a decision is adopted, there is also limited scope to vary it. Parties do, however, have the right to apply for judicial review with the High Court on grounds of illegality, procedural unfairness or irrationality. To date, there has been one case that has led to a judicial review application, the outcome of which is pending.

Although the maximum statutory review period is approximately five months, reviews may take much longer in complex cases (eg, eight-plus months), especially as information gathering can be onerous and information requests stop the review clock. In complex cases, the ISU may also seek a voluntary extension.

EU Foreign Subsidies Regulation

On 28 November 2022, the EU formally adopted the FSR, which came into force on 12 July 2023. The FSR gives the EC new and far-reaching powers to examine and request filings for any deals where it suspects that one or more of the parties are benefiting from non-EU member state financial support, which gives them an unfair competitive advantage over European businesses that do not enjoy comparable state backing due to the limitations imposed by EU state aid rules. This precedes a mandatory, suspensory notification regime that will apply from 12 October 2023, and which will attach to a range of transactions and tenders.

Notification obligation

The FSR introduces three new mechanisms to allow the EC to examine non-EU subsidies:

- General market scrutiny power (applying from 12 July 2023): the EC has discretion to investigate and request filings be submitted for any market situation where it suspects that non-EU subsidies are distorting competition. There are no applicable financial thresholds; this provision gives the EC a wide call-in power that may be exercised in relation to relatively low-value transactions and public procurement processes. The EC may also investigate foreign subsidies granted up to five years before the FSR started to apply.
- M&A (applying from 12 October 2023): a mandatory filing requirement for deals involving: an EU-established party that has €500 million or more in EU turnover; and where all transacting parties have received, in total, financial contributions of €50 million or more from non-EU member states over the previous three years.
- Public procurement (applying from 12 October 2023): a mandatory filing requirement for tenders involving: a contract value of €250 million or more; and a company that received at least €4 million in financial contributions from non-EU member states over the previous three years.

The concept of 'foreign subsidy'

The concept of foreign subsidy is imprecisely defined by the FSR as a 'financial contribution provided directly or indirectly by a third country, which confers a benefit'. The 'financial contribution' concept is also broadly defined to include direct transfers of funds or liabilities (eg, capital injections, grants, loans, loan guarantees, fiscal incentives, debt forgiveness, debt to equity swaps and rescheduling), the foregoing of public revenue otherwise due (eg, tax exemptions, investment tax credit or production tax credit incentives, and statutory benefits or reliefs), and the provision or purchase of goods or services (eg, between a company and a public authority or private company whose actions are attributable to a non-EU government). The FSR also applies an expansive view of 'third country', capturing central, regional or local governments and state-owned (or controlled) enterprises of non-EU member states. Based on guidance published to date, there will likely soon be a focus on sovereign wealth funds and state-owned enterprises.

For many companies, it will be challenging and time-consuming to develop internal systems to track and collect data, to determine whether a transaction or public procurement process requires notification or is at risk of call-in under the general market scrutiny tool. This is particularly the case for private equity funds, which are unlikely to have this type of data on their controlled portfolio companies at a centralised level. Filing obligations and deal risk therefore need to be assessed early on in deal planning.

Substantive assessment

When reviewing a deal, the EC will weigh the 'negative effects of a foreign subsidy in terms of distortion on the internal market with [the] positive effects [in EU] on the development of the relevant economic activity'.

Much like a merger control review, the EC can ultimately decide to approve the deal, approve it conditionally or prohibit it altogether. The EC has indicated that remedies may include structural divestments (eg, unwinding or divestment order); reducing capacity or market presence; licensing on fair, reasonable and non-discriminatory terms; and publishing the results of R&D or other behavioural commitments (eg, repaying foreign subsidies, changing the governance structure of the company, etc). However, unlike in the merger control context, parties should keep in mind that structural remedies, such as divestments, may be difficult to offer as it is unlikely that any concerns will be adequately addressed by divesting a specific part of the business.

At least during this initial phase of enforcement, and while only limited guidance is available on how to apply key concepts and which foreign subsidies are of the greatest concern, FSR outcomes will be unpredictable. FSR reviews are also at greater risk of political interference and changes in policy focus compared with traditional competition merger control reviews.

Sanctions

Sanctions for non-compliance with the FSR may result in a one-off fine of up to 10 per cent of a corporate group's global turnover. Where incorrect, incomplete or misleading information is provided, the EC may impose fines of up to 1 per cent of the corporate group's global turnover or periodic fines of up to 5 per cent of the corporate's group average daily global turnover.

Practical considerations for private M&A transactions

Timing implications

Given the suspensory nature of a number of merger control and FDI regimes, as well as the mandatory FSR regime, the relevant review period can have particularly acute timing implications for closing deals. For instance, the FDI review process usually takes between four and six months in France, Germany and India. In complex cases, the review period can take as long as nine months to more than one year if remedies are required. FSR review timelines are likely to run for a minimum of three to five months, even in relatively straightforward cases. More complex reviews may run for significantly longer, potentially 12 months or more, with deal timelines likely to be significantly disrupted. In complex merger control reviews, parties are also increasingly witnessing longer review timelines; in the US, for example, there have been as many withdrawals as there have been prohibitions and conditional clearance decisions in the EU. Such long lead times can extend far beyond other closing conditions (including merger control clearance in no-issues cases). It is, therefore, crucial that an FDI and FSR risk analysis is conducted ahead of negotiating conditions and termination rights in a transaction agreement.

Risk allocation

As described above, regulatory screening raises the potential of prohibitively long review periods and the power of the relevant authorities to impose (substantial) remedies or prohibit or unwind transactions altogether. Parties should therefore consider the allocation of risk in transaction agreements from the outset and may increasingly desire deal protections such as a 'hell or high water' clause, obliging the buyer to proceed with the transaction regardless of any obligations imposed in connection with any regulatory approval, or reverse termination fees.

It will be equally important for parties to give careful consideration to the risk of call-in that may exist under some merger control regimes (eg, EU and UK), FDI regimes (eg, UK) and the EU FSR regime, at an early stage when conducting diligence and negotiating deal documents. In particular, parties may want to include springing conditions in transaction documents to cover off the risk of call-in.

Information gathering

FDI and FSR filings, especially, will require the parties to provide an extensive amount of (sensitive) information to the relevant authorities. During FSR reviews, the EC will have the power to require the production of large quantities of sensitive information, including market data, information on contractual arrangements with non-EU states and internal documents. The EC will also be able to carry out interviews and dawn raids (including dawn raids outside of the EU, provided it has approval from the relevant non-EU member state to do so).

Furthermore, where requests for additional information may have to be issued, the FSR regime and certain FDI jurisdictions (including France, Italy and the UK) have the ability to stop the clock of the review period until the requested information has been provided. Expedient information gathering and initiation of the review period can materially advance the transaction closing date.

Overall approach

Regulatory risk assessments for cross-border M&A transactions have grown increasingly complicated with the recent uptick in intervention rates by antitrust regulators in major jurisdictions, such as the US, UK and EU, the exponential rise of new FDI screening regimes in G20 countries, and the newly-established EU FSR regime.

The ever-growing scope of governments' jurisdictions to review, together with the potential sanctions and remedial action that can be imposed on parties that fail to comply, necessitate engagement with potential antitrust, FDI and FSR issues at an early stage of the transaction process. However, prudent attention to these regulatory issues can minimise the negative timing and risk implications now present in cross-border transactions.

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