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SPOTLIGHT ARTICLE REPRINT January 2024

Navigating M&A deal clearance in a complex regulatory environment

BY FRANCES DETHMERS, MATTHEW YEOWART AND EMMA WALSH

M&A dealmakers face more regulatory obstacles than ever before to secure clearances for transactions. There are more than 130 jurisdictions with active merger control regimes, and a growing number of jurisdictions with foreign direct investment (FDI) screening mechanisms to assess whether transactions raise national security or other 'public interest' concerns. The European Union's (EU's) Foreign Subsidies Regulation (FSR), which gives the European Commission (EC) far-reaching powers to investigate foreign financial contributions capable of distorting competition, and the rollout of digital markets antitrust regimes has further complicated regulatory risk assessments. More deals than ever before are being reviewed and there is a widening range of theories of harm that may disrupt or prohibit deal consummation.

This article considers these regulatory roadblocks in turn, highlighting the 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 burdens can be minimised.

Global merger control

Merger control reviews have long been established in many jurisdictions; however, outcomes are becoming less certain as regulators expand their jurisdictional reach, seek to correct perceived historic underenforcement, and consider novel theories of harm, including taking action to prevent loss of nascent competition.

The EC and the UK Competition and Markets Authority (CMA) have discretionary powers to call on to review transactions that do not obviously meet the jurisdictional thresholds. The EC is actively investigating transactions under its revised approach to article 22 of the EU Merger Regulation, and the CMA has a dedicated Merger Intelligence Unit that monitors deal activity, often proactively sending questions to transacting parties that have not approached the CMA under their own initiative to assess whether the deal is a good candidate for formal review. This creates risks for dealmakers as requests for

information raised at a late stage may have serious implications for overall deal timing.

Globally, regulators appear to be particularly interested in deals in strategic industries, notably, pharmaceuticals, digital technology and raw materials. Dealmakers in these industries, particularly those working on high-profile transactions, should consider proactively briefing regulators, where this option is available, to avoid late-stage interventions.

Despite similarities in the toolkits of global regulators to review transactions, transacting parties face meaningful risks of divergent outcomes. For example, in May 2023 the EC approved Microsoft's $68.7bn acquisition of Activision Blizzard, a month after the CMA blocked the deal. It took Microsoft submitting a new and substantially different deal, which excluded cloud gaming rights, to secure CMA clearance. In addition, in early 2022 the EC conditionally cleared Meta's $1bn acquisition of Kustomer after the CMA had unconditionally cleared the deal four months prior. And in March 2022, the CMA blocked the $5bn Cargotec/Konecranes merger only a month after the EC had cleared the deal, subject to remedies.

It is increasingly difficult to predict how regulators may react to a transaction. In deals that give rise to competition concerns, there is also divergence on remedies imposed by regulators. The CMA has shown a preference for blocking deals instead of accepting remedies. Similarly, in the US, the Federal Trade Commission (FTC) and Department of Justice (DOJ) are increasingly sceptical of remedies and are willing to litigate to block deals. Consequently, the burden on the parties to convince regulators that a proposed remedy package will adequately address competition concerns is heavier than it once was. In complex deals, it is therefore advisable for parties to consider remedy packages early and to proactively offer these up to regulators at a point when the regulator has sufficient procedural flexibility to consider the remedy offer. Sarah Cardell, chief executive of the CMA, noted in the press release concerning clearance of the Microsoft/Activision Blizzard acquisition that: "Microsoft had the chance to restructure during our initial investigation but instead continued to insist on a package of measures that we told them simply wouldn't work. Dragging out proceedings in this way only wastes time and money."

Digital markets regulation

Digital markets also continue to be a focus area for regulators with many developing new rules to regulate the most powerful companies. The EC's Digital Markets Act (DMA), applicable from 2 May 2023, created a tailored regulatory regime for large tech companies. On 6 September 2023, the EC designated six digital firms as 'gatekeepers': Alphabet, Amazon, Apple, ByteDance, Meta and Microsoft. These companies are now subject to enhanced compliance obligations, designed to pre-emptively tackle unfair business practices in the tech industry. Firms with 'gatekeeper' status are expected to be fully compliant with DMA obligations by March 2024.

Further, the UK Digital Markets, Competition and Consumers Bill, published on 25 April 2023, is expected to significantly broaden the powers of the CMA in the digital markets space, not least by enabling the CMA to analyse acquisitions of nascent competitors by well-established players that could reinforce their market position.

The Bill will also give the CMA's Digital Markets Unit powers to classify companies with 'strategic market status' and impose on them a mandatory filing requirement where they acquire at least 15 percent of a target with a UK nexus for a consideration of £25m or more.

Germany has equivalent legislation that entered into force a year before the DMA. The German Federal Cartel Office has already concluded designations, some of which are already under appeal, and is progressing swiftly with its own investigations in parallel with the EC's DMA investigations.

Global FDI

For more than 30 years, the Committee on Foreign Investment in the United States (CFIUS) 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 23 of the 27 EU member states, with Ireland and Bulgaria expected to follow in 2024.

While a few of these FDI regimes are already mature, such as Germany's FDI regime which has been in place for more than a decade, many of them are newly established, typically drafted broadly, and may catch transactions with no obvious sensitivity. The UK government has recognised the need to improve the workings of its foreign investment screening mechanism, which was set out in the National Security and Investment Act (NSIA) 2021, and has launched a call for evidence, open until 15 January 2024, to receive public views to refine the scope of the NSIA's mandatory notification requirements and improve assessment processes.

It is positive to see that governments recognise FDI as an area needing improvement, especially given the level of divergence between various FDI regimes around the world. Different jurisdictions currently identify different sensitive sectors for the purpose of FDI assessments and use applicable regimes to pursue industrial strategy objectives. The UK identifies 17 broadly defined 'sensitive sectors of the economy', such as artificial intelligence (AI), communications, defence, military and dual-use, among others, while Italy's FDI regime takes a more granular view of activities in certain sectors, including data collection and critical technologies in the management of crops, livestock, fisheries and aquaculture.

The most apparent area of divergence is seen in the sectoral coverage of FDI regimes. While most jurisdictions take a focused approach, identifying, albeit broadly, particularly sensitive sectors within which foreign investments may be subject to review, some jurisdictions, including Australia, Canada and Germany, do not limit their powers according to relevant sectors.

Consequently, it may not be readily apparent to deal teams whether their

transaction is likely to trigger an FDI filing obligation because of the variance in rules across jurisdictions. Therefore, it is important that dealmakers seek specialist advice on possible FDI filings at an early stage of the transaction timeline, particularly given the potentially serious consequences of failing to comply, which often includes fines and potential criminal sanctions for responsible directors.

EU FSR

The FSR is the most recent addition to the increasingly complex regulatory environment for M&A transactions, having come into force on 12 July 2023.

The FSR gives the EC far-reaching powers to examine and request filings for any deals where it suspects that one or more parties are benefitting from financial contributions from non-EU states that could have the effect of distorting competition in the internal market. The FSR enables the EC to request a large amount of sensitive data from companies, including controlled portfolio companies. FSR data gathering tends to be time consuming and may be challenging to complete in a specific deal setting. Deal teams that expect planned transactions may trigger an FSR filing should therefore consider collecting data pre-emptively so that it is readily available, as the FSR processes could otherwise delay timeline to closing.

The FSR is a new regime, so transacting parties and the EC are still navigating the legislation. Based on currently available guidance, there will likely be a focus on financial contributions received from non-EU sovereign wealth funds and non-EU state-owned enterprises. Dealmakers that prepare in advance for an FSR filing and conduct an expansive data collection exercise can minimise the risk of deal disruption as a result of the time and labour-intensive FSR engagement process post-signing.

Conclusion

The increasingly complex regulatory environment faced by dealmakers makes it more challenging than ever to obtain clearances for M&A transactions. However, with sufficient planning at the outset of the deal, these regulatory obstacles can often be overcome, and review processes appropriately managed to minimise disruption. ■

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