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April 2020

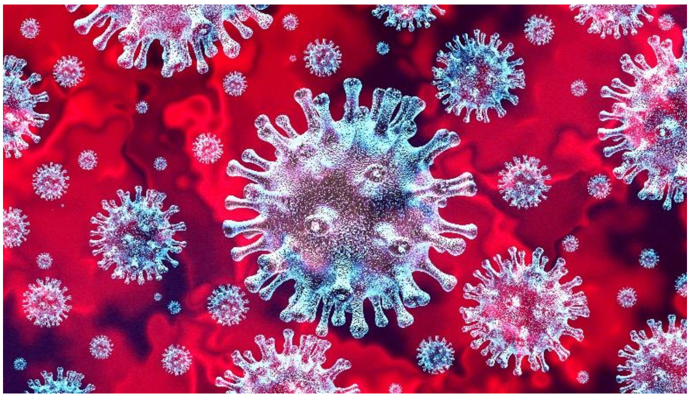
Impact of COVID-19 on Merger Control

The COVID-19 pandemic sweeping the world is having a hugely unprecedented and disruptive impact on businesses. For many large companies and SMEs alike, the inevitable reality is that they may fail - unable to escape insolvency (despite a range of governmental support measures). While M&A may be on hold for the moment with potential investors taking a cautious approach to investment, in the months to come there may well be a marked increase in buy-outs of distressed businesses, restructurings or other emergency investments.[1]

Such transactions may well need to take place very quickly and require fast merger control approvals[2] **at a time when competition authorities around the world, including the European Commission ("Commission") and the Competition & Markets Authority ("CMA"), are alerting companies to delays in merger control reviews or asking companies not to file merger notifications for the time being.**

As a result, some companies may be tempted to take their chances and not notify their transactions to the relevant competition authorities. Alternatively, companies that are either waiting to notify, or waiting for a decision, will remain in limbo for an extended or even indefinite period of time.

We consider how the COVID-19 pandemic is having an impact on merger control in the EU and UK, and how companies can best navigate the rules to mitigate any competition risks to their transactions in these uncertain times.



Impact of COVID-19 on EU merger control?

Firstly and above all, the Commission announced and made very clear on 13 March 2020 that *"due to the complexities and disruptions caused by the Coronavirus, companies are encouraged to delay merger notifications originally planned until further notice, where possible"*.[3] This is due to a variety of factors, including the need for staff to work remotely (i.e. no in-person meetings albeit it may be possible to hold video conferences/conference calls) and the need to reorganise certain processes (i.e. temporary acceptance of electronic merger submissions with delivery of paper originals at a later date), all of which will lead to a less efficient process. But above all, this is due to the fact that proper market testing (i.e. the collection of views from suppliers, customers and competitors on the transaction which is a crucial part of the merger review process) will be difficult as third parties are likely to be more focused on the day-to-day challenges of keeping their businesses afloat.

However, the reality is that the Commission is officially open for business. Transactions that meet the EU merger control thresholds will still need to be mandatorily notified and receive pre-completion clearance from the Commission before parties may

[1] Equally, there may be opportunities for other companies to buy other businesses on more attractive terms than would be available in normal circumstances. Alternatively, creditors may unintentionally find themselves in a position where they acquire control over a business.

[2] Interestingly, this in contrast to the European Commission's Temporary Framework for State aid approvals which allows such schemes to be approved rapidly within 24-48 hours. No such special rules have been put in place for merger reviews.

[3] See https://ec.europa.eu/competition/mergers/information_en.html

close the transaction.[4] Indeed, until the end of the Transition Period currently set at 31 December 2020 (albeit this may be extended), the UK continues to be an EU Member State and remains subject to EU merger control rules. There have been no exceptions or relaxations to the rules in this respect.

So what impact is COVID-19 having on merger control reviews? What have we seen so far and what can we expect at the EU level?

- **Notified mergers.** The Commission will prioritise cases that have already been formally notified to it and which are under review. It will also continue to accept simplified merger filings.[5] Therefore, these types of deals are less likely to be affected, although delays are inevitable - especially due to the difficulty of obtaining third party views during market testing.
- The Commission may as a result consider ways to pause the formal review periods by issuing additional requests for information ("**RFIs**")[6] before deciding to "stop the clock" or even "stop the clock" and suspend the review of merger transactions.[7]
- The Commission could also invite parties to a merger to withdraw their notifications unilaterally and refile at a later date.
- **Transactions not yet filed.** For transactions signed but not yet filed, the Commission is encouraging parties to delay notifications which are not considered urgent until further notice unless parties have a compelling reason as to why timing is a critical issue in their case (e.g. a long-stop date coupled with a significant break-up fee). Therefore, the Commission is unlikely to accept new filings and may even reject new filings entirely on the basis of incompleteness.
- Where parties nonetheless decide to start engaging with the Commission in pre-notification discussions, parties should be aware that they are likely to experience extended pre-notification periods (e.g. by up to two to four weeks - if not more - depending on measures taken by national governments and the Commission itself).
- **Future transactions.** Parties to transactions that have not yet signed should pay close attention to include realistic long-stop dates in their transaction agreements and avoid any unrealistic or rigid filing periods in any reasonable cooperation/effort clauses to take account of the current delays due to COVID-19.[8] The risk of delays will persist beyond the outbreak itself, as the Commission will inevitably have to process a backlog of cases.
- Given its strained resources and inability to carry out market testing in the usual way during this crisis period, the Commission may well err on the side of caution and even prohibit a merger unless it can overcome its doubts about the impact of a transaction on competition.
- **"Jump the Gun" or "Seek Derogations"?** Given there has been no flexing of the rules, parties should not be tempted to circumvent mandatory merger control filings/approvals during the crisis and flout any "standstill obligation" (i.e. the obligation to refrain from implementing notified transactions pending approval - otherwise known as "gun-jumping"). Dissuading such conduct will remain a priority area for the Commission and can lead to significant fines on the parties to a deal (e.g. up to 10% of the group revenues of the companies concerned).[9]
- In exceptional circumstances, an application for a derogation of the "standstill obligation" might be possible, albeit derogations of this kind have been difficult to obtain in the past.[10] The Commission, in deciding whether to award one, will balance the likely harm to the parties if a transaction was forcibly suspended (e.g. parties facing insolvency

[4] A transaction must be notified to the Commission if: (1) the combined aggregate worldwide turnover of all undertakings concerned is more than €5 billion and the aggregate EU-wide turnover of at least two of the undertakings concerned is more than €250 million; **or** (2) the combined aggregate worldwide turnover all the undertakings concerned is more than €2.5 billion, €100 million worth of turnover of all the undertakings is generated in each of at least three Member States and in each one of these Member States at least two of the undertakings generate €25 million worth of turnover individually, and the aggregate EU-wide turnover of at least two of the undertakings concerned is more than €100 million; <u>unless</u> each of the undertakings concerned achieves more than two thirds of its aggregate EU-wide turnover within one Member State (in which case it may be referred to the competition authority of that Member State).

[5] Since 13 March 2020, the Commission has accepted the filing of 28 simplified notifications, whereas it has accepted only 1 full notification.

[6] Note that RFIs may well become increasingly more time-consuming and burdensome than they are already, given the difficulty for the Commission to collect information during its normal market testing process

[7] The Commission recently took this decision in *Fincantieri / Chantiers de l'Atlantique (Case No. M.9612).*

[8] Supplements to already signed SPAs or waivers to long-stop dates or other alternative arrangements might become necessary to take account of delays as a result of COVID-19.

[9] Telecoms company Altice was fined €124.5 million by the Commission in 2018 after it implemented its acquisition of Portuguese telco PT Portugal before notification and approval. Last year, Canon was fined €28 million after it jumped the gun by structuring a transaction to acquire Toshiba Medical Systems Corporation allegedly to circumvent merger control requirements.

[10] There have been just over 40 transactions that have been granted derogations from the standstill obligation under the EU merger regime since its adoption in 1990.

as a result of COVID-19) and the potential harm to competition in the internal market if the transaction were allowed to complete. Such a derogation would not, however, mean that the Commission would give up its investigation and clear the transaction. The investigation would still take place and complete at a later date.

Impact of COVID on UK merger control?

In the UK, importantly, the merger control regime remains a voluntary one where no prior notification to, or approval from, the CMA is required for parties to complete a transaction. Unlike the Commission, the CMA has so far not expressly indicated that there will be delays to merger reviews. Rather, the CMA has raised with parties that have already engaged with the CMA on merger notifications that: (i) pre-notification discussions may take longer; (ii) the CMA may engage in informal market testing during pre-notification discussions; (iii) it may be necessary to delay formal notifications to avoid the start of the statutory Phase 1 clock; and/or (iv) extensions to statutory timeframes may be sought by the CMA.

With this in mind, the present circumstances may be seen as a fortuitous way to progress a deal with a much-reduced fear of CMA intervention, even if the merger control thresholds are technically triggered,[11] given the latter's more limited ability to fully mobilise its resources. Unlike mandatory notifications to the Commission, there are no penalties or fines for failing to file with the CMA.

However, where an acquisition is completed without pre-merger clearance, the CMA is able to open a merger investigation within a period of up to 4 months from the deal being made public or otherwise being brought to the CMA's attention. If there is a reasonable likelihood that a completed transaction could come to the attention of the CMA, there are a number of risks for the acquiring party – in particular:

- The CMA will likely impose a form of Initial Enforcement Order ("**IEO**") known as a 'Hold Separate' Order. Such an order requires parties to continue to run their respective businesses independently and prohibits any integration, the rationale being that such steps might prejudice the CMA's investigation into the likely effects of the transaction on the UK market. A further form of IEO that may be imposed – in the most extreme circumstances – is an unwinding order, which (as the name suggests) requires any parties who have taken steps to integrate their businesses post- or, indeed, pre-closing to unwind any such steps. Due to the inevitably high costs involved in forcing merging companies to unwind (as far as possible) any integration of their two businesses, an unwinding order is seen as one of the more draconian weapons in the CMA's arsenal and will only be imposed in exceptional circumstances.[12]
- The CMA may also require the appointment of a monitoring trustee (at the parties' cost) and/or a so-called "hold separate manager" to ensure compliance with, and appropriate implementation of, the IEO and any unwinding order.[13]
- Ultimately, the acquiring party could also be ordered to divest all or part of the acquired business.

Therefore, it is key for parties to a merger having any connection to the UK to assess whether the UK merger control thresholds are met and whether it would be advisable to notify the deal to the CMA. It is important to remember also that, even if a firm has ceased trading, the acquisition of either its share capital or all (or parts) of its assets may still be

[11] The CMA has jurisdiction to investigate a transaction if: (i) the UK turnover of the target is £70 million or more; and/or (ii) the transaction would create a share of, or increase to, 25% or more share of the supply of any relevant goods or services in the UK (or a substantial part of the UK).

[12] To date, the CMA has only imposed an unwinding order in a very limited number of cases, the first of which was in relation to Tobii's acquisition of Smartbox.

[13] In respect of a breach of any form of IEO, the CMA may impose a discretionary fine up to 5% of the parties' global turnover. See Section 94A of the Enterprise Act 2002. The Competition & Markets Authority, *Interim measures in merger investigations,* 28 June 2019, 1.10, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/813144/Interim_Measures_in_Merger_Investigations_June_2019.pdf

capable of investigation under the UK merger control regime.[14]

Failing Firm Defence?

As a result of COVID-19 and the sale of more distressed assets, companies to a merger may also try to use the "failing firm" (or "flailing firm")[15] defence at both the EU and UK level to secure clearances for some transactions that would otherwise have been prohibited. However, the parties would need to argue successfully that the only alternative would be insolvency and exit of the target business, which would be more harmful to competition than the proposed acquisition. In other words, the merger is presented as a rescue merger which is the least adverse outcome as against the counterfactual of the exit of the target.

However, the burden of proving the above is, in practice, very challenging. The Commission will only clear a transaction on the basis of the "failing firm" defence, for instance, if: (1) the failing target would be forced out of the market in the near future on account of its financial difficulties (if not taken over by another company); (2) there would be no less anti-competitive alternative than the proposed merger; and (3) in the absence of the merger, the assets of the failing target would also inevitably exit the market.[16] The CMA's approach largely mirrors the Commission's approach here with similar (albeit, slightly differing) criteria.[17]

In the course of making any assessment of the failing firm defence, both the Commission and the CMA have taken a rather restrictive approach, carefully examining and testing significant amounts of evidence put forward by the parties in support of such defence, as well as relying heavily on evidence from third parties. In particular, they will thoroughly examine the target's internal documents and financial records to help determine if the transaction is a genuine rescue merger or part of the parties' strategic plan.

Notifying parties should therefore be ready to present a credible story if they wish to benefit from such a defence. However, it remains to be seen whether the Commission and/or the CMA may be more disposed to accept such a "failing firm" defence or not in the current economic circumstances and given their lack of resources at present.

Foreign Investment Rules

Before COVID-19, rising national protectionism had been driving strong screening of foreign investment across the globe. Now, COVID-19 has resulted in a number of countries taking a very strict approach on foreign direct investment ("**FDI**") to protect vulnerable strategic assets and critical national infrastructure from being taken over by foreign owners.

On 25 March 2020,[18] the Commission published guidelines calling, on the one hand, for Member States with existing FDI review systems to utilise all tools available to them and, on the other, encouraging those remaining Member States with no system of FDI review yet in place to adopt full screening mechanisms to protect sensitive assets (e.g. healthcare, medical research, biotechnology, infrastructure essential for security and public order) from foreign takeover during the crisis. On 12 April

[14] For instance, the UK's Supreme Court has previously confirmed that on the facts of the case, the completed acquisition of certain assets of a liquidated entity (including vessels, staff, brand, customer lists and property) was an acquisition capable of being investigated under the UK merger control rules. See Société Coopérative de Production SeaFrance SA v The Competition and Markets Authority & Another [2015] UKSC75.

[15] The "flailing" firm defence is an alternative to the failing firm defence. It is where a company is not on the verge of collapse but where its competitive significance has weakened or is likely to decline going forward.

[16] The European Commission. *Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings*. (2004/C 31/02) para 90.

[17] These include: (i) whether the target company would inevitably exit the market if the merger did not take place; (ii) whether there is an alternative purchaser for the target firm or its assets that would result in a substantially less anti-competitive outcome (i.e. there is no less anti-competitive alternative purchaser); and (iii) if the target firm did leave the market, how a subsequent sale of (e.g.) its assets would be likely to affect the relevant market (i.e. the loss of the target and its assets would not have a less anti-competitive effect than the transaction). See Office of Fair Trading. *Merger Assessment Guidelines*. (September 2010) para 4.3.8.

[18] Communication from the Commission – Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe's strategic assets, ahead of the application of Regulation (EU) 2019/452 (FDI Screening Regulation). (C(2020) 1981 final) published on 25 March 2020. Available at: https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf

2020, Commissioner Vestager reportedly told the *Financial Times* that she encouraged EU Member States to buy shares in companies to alleviate concerns that COVID-19 could leave some businesses open to takeovers by foreign investors.

In the EU, new FDI rules under the framework regulation for the coordinated screening of FDI among Member States and the Commission on public security grounds ("**Framework**")[19] will become applicable from 11 October 2020. The coordination mechanism allows for information to be requested vis-à-vis the parties to a transaction from national authorities and for the Commission to issue non-binding opinions which the Member States must duly consider when reaching a decision as to whether to permit a foreign investment. The new rules are applicable retroactively and opinions may be issued up to 15 months after the investment is completed. This means that foreign investments completing from 11 July 2019 onwards face possible intervention via the co-operation mechanism once the mechanism is established. Such transactions could, depending on available remedies under national law, be subject to enforcement action against the investment post-completion.

The UK does not yet have in place any legislation that differentiates between foreign and domestic investments – the UK's White Paper published in July 2018, which contained proposals for a new national security review regime,[20] has not yet been implemented into law. However, the UK government remains committed to adopting a more stringent FDI review regime in 2020 and included a new National Security and Investment Bill in its legislative programme published in December 2019.[21]

There are also more than 100 countries worldwide that have FDI regimes in place, including for instance, Spain, Italy, France, Germany, Australia, USA, Canada, China, Russia and Japan. As such, M&A transactions involving either a foreign buyer, or a buyer with a foreign parent company, may be subject to greater scrutiny in the coming weeks/months and face prolonged approval processes.

Non-EU investors investing in critical infrastructure and inputs in the EU therefore need to carefully consider foreign investment reviews at this highly volatile time and such considerations need to be factored into deal timetables. Foreign buyers need to make sure that they are aware of existing national FDI regimes and keep up to date with proposed new regimes, to ensure that they understand the rules and identify a prudent regulatory strategy.

Key Messages

Although it is business-as-usual insofar as the usual merger control regime rules apply, the COVID-19 outbreak means that both the Commission and the CMA are severely impaired in their ability to investigate merger transactions. Delay to merger reviews are expected until such COVID-19 restrictions are lifted. However, this position is not practical longer term for companies that are looking to acquire a number of failing businesses in the coming months when faster approvals will be critical. Parties therefore need to carefully consider how best they can work with the Commission/CMA to secure their merger control approvals as efficiently as possible.

- **Determine swiftly if any merger filings in any jurisdictions are triggered by a deal** and carefully monitor the lifting of any lockdown measures that may impact the approach of competition authorities to merger control in those countries.

[19] Regulation (EU) 2019/452 of the European Parliament and of Council establishing a framework for the screening of foreign direct investments into the Union (LI 79 1/1) published on 19 March 2019. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX%3A32019R0452&from=EN

[20] The UK government. *National security and investment: a consultation on proposed legislative reforms.* 24 July 2018. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/728310/20180723_-_National_security_and_investment_-_final_version_for_printing__1_.pdf

[21] See https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2019-12-20/HCWS11/

- **Consider if it may be possible to structure the deal in a different way to avoid merger control filings** (e.g. shifting alliances, option structures) **or obtain a partial/swifter closing of the deal** (e.g. carve-outs).
- **Engage with the Commission/CMA early on in a transparent manner to avoid antagonising the regulator.** Simply notifying a transaction may put the regulator under undue time pressure and may also result in more complicated and longer proceedings than would otherwise be the case.
- **Carefully review the contractual arrangements of the deal** – especially the "long-stop date" and termination rights as well as the consequences of failing to meet those dates. If COVID-19 prevents performance of the contract consider the ability to renegotiate or seek waivers.
- **Submit a clear explanation of the reasons why the review of the deal should be given priority** (e.g. to prevent a business from collapse) and take advantage of any fast track procedures.
- **Produce a strong case as to why the transaction should be permitted and prepare as complete a merger filing as possible so that it can be promptly submitted, in order to make the review process easier for the Commission/CMA.** Such an approach may be particularly sensible in merger transactions that will (or are likely to) raise substantive issues in the EU or UK.
- **If the transaction is in the public domain, volunteer or ask whether the Commission/CMA would like to undertake an informal market testing in parallel with pre-notification discussions** given the challenges regulators may face in collecting views from third parties on the transaction. This may help avoid the "stopping of the clock" during the formal review process, a referral of the deal to Phase 2 or putting parties in a position to withdraw and re-notify a merger notification.
- **Consider requesting derogations from any "standstill obligation"** (i.e. suspensory obligation to mandatory filings)**.**
- **Be proactive and available to address any questions from the Commission/CMA,** especially if either organisation are able to move more quickly than anticipated in their review of the transaction.
- **Avoid gun-jumping or breaching any IEO**, as the regulators have the ability to impose fines on the parties to a transaction.
- **Consider whether to use the so-called "failing firm" defence to request that the transaction be cleared**, especially where a target business is likely to collapse in the absence of the transaction. This could be a viable tactic to gain CMA or Commission approval for a deal.
- **Consider the impact of foreign investment regimes on the transaction.**

Contact us

If you would like to know about any of the issues raised in this briefing, our Competition Team would be happy to speak to you.

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