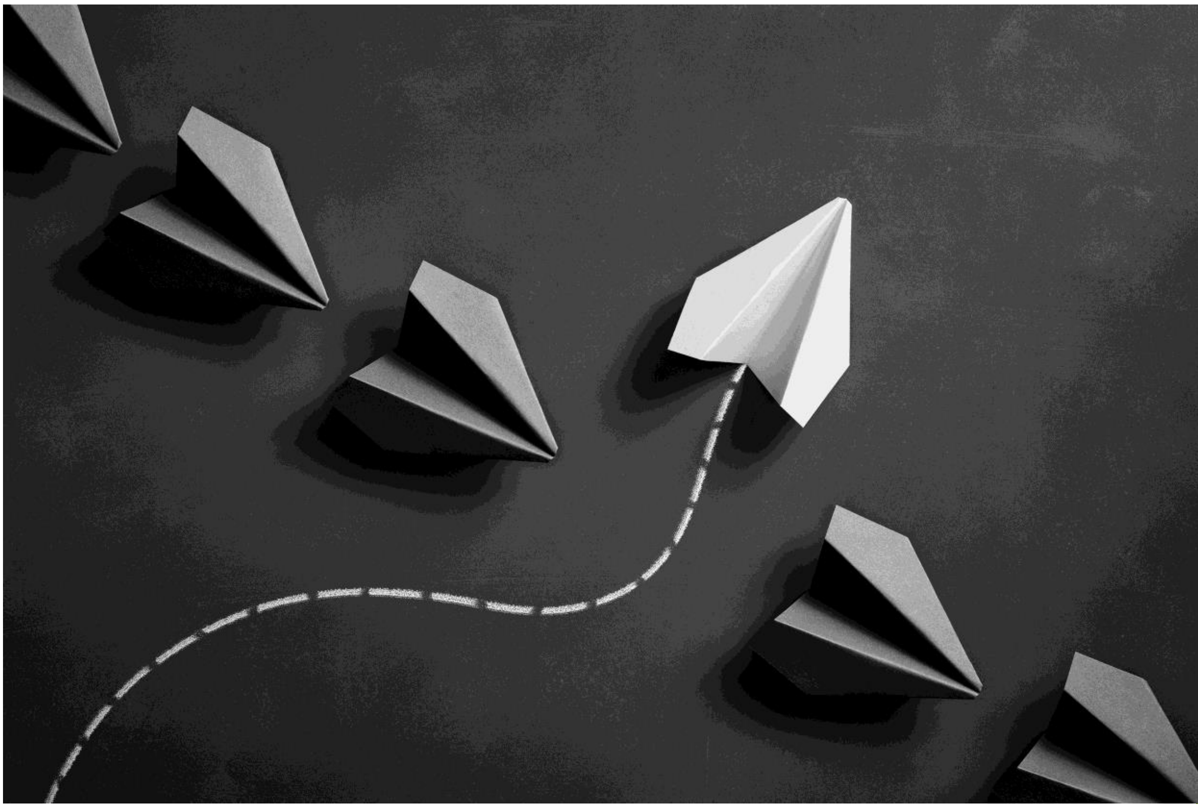
Quickguides

UK public bids: interaction between the Takeover Code, merger control rules and other regulatory controls



UK public bids: interaction between the Takeover Code, merger control rules and other regulatory controls

Quickguide overview

This Quickguide provides an overview of the interaction between the Takeover Code, merger control rules and other regulatory controls, in the context of UK public bids. It considers:

- the importance of undertaking a detailed competition analysis at a preliminary stage;
- the relevant provisions of the UK and EU merger control regimes;
- the requirements of the Takeover Code regarding regulatory authorisations;
- UK foreign investment controls;
- overseas foreign investment controls;
- other potential regulatory issues; and
- overseas approvals required by the bidder.

For further information on any of the above areas or if you have any questions on the rules applicable to UK takeovers more generally, please see the Ashurst UK Guide to Takeovers or please speak to one of the contacts listed on the final page of this Quickguide, or your usual Ashurst contact.

For more information on merger control or the UK foreign investment controls, please see: (1) our Quickguide on UK merger control; (2) our Quickguide on EU merger control and (3) our updates on the proposed UK National Security and Investment regime here and here.

Brexit

The UK left the EU on 31 January 2020 and the Brexit Transition Period ended on 31 December 2020. On 1 January 2021 the UK and EU became two fully distinct regulatory, legal and customs territories, whose relationship is governed by the Trade and Cooperation Agreement (TCA).

This means that the UK is no longer part of the EU for jurisdictional, procedural and substantive assessment purposes under the EU Merger Regulation. In particular, the "one-stop shop" system established under the EU Merger Regulation no longer applies to the UK, meaning that the UK Competition and Markets Authority (CMA) is now permitted to investigate transactions in parallel with the European Commission.

UK public bids: interaction between the Takeover Code and merger control rules and other regulatory controls

1. Application of merger control rules to UK public bids

Merger control rules are intended to control or prevent anti-competitive mergers and acquisitions. If a takeover raises serious competition concerns, merger control rules could result in it being prohibited, or permitted only subject to conditions (which may significantly affect the commercial rationale for the bid). Merger control rules may also need to be considered even if the takeover does not appear to raise any substantive competition concerns. Many regimes around the world have mandatory pre-completion notification requirements for any merger or acquisition which meets specified financial thresholds (which will often be the case for public takeovers given the size of the parties involved), in some cases even if the jurisdiction in question has no obvious nexus to the transaction.

2. Competition analysis

At a preliminary stage of the bid process, a detailed analysis should be conducted to establish in which jurisdictions (if any) approvals/clearances may be required. This is vital even if competition concerns are not anticipated, because:

- completion of the takeover may not be permitted until merger clearances have been granted;
- significant fines may be imposed for failure to notify and/or for proceeding with the takeover without clearance; and
- consideration will need to be given as to (i) allocation of risk in relation to the clearance process, in the case of a recommended deal (for example, the target may wish to obtain a "hell or high water" undertaking from the bidder in relation to obtaining the necessary clearances, in conjunction with a reverse break fee should those clearances not be obtained); (ii) documenting the clearance conditions in the offer terms; and (iii) timing issues when seeking clearances bearing in mind the strict Takeover Code (Code) timetable on a contractual offer.

The starting point will be to determine whether the proposed takeover is caught by:

- any merger control regime which requires mandatory notification, such as the EU, United States, China or Germany; and/or
- any voluntary merger control regime where it is advisable to notify in light of offer timetable considerations and/or the risks involved in not notifying, such as the UK (see section 3 below).

Consideration must be given to the impact of any notification on the offer timetable, and whether to make the offer subject to any competition clearance conditions.

3. UK merger control regime – Enterprise Act 2002

UK merger control thresholds

Under the UK regime, a takeover will be caught by the merger control rules where either:

- the target's UK turnover exceeds £70 million; or

- as a result of the takeover, a share of 25% or more of the supply or purchase of goods or services in the UK (or a substantial part of the UK) will be created or enhanced.

If the transaction is in one or more of the military and dual-use, multi-purpose computing hardware, quantum technology, artificial intelligence, cryptographic authentication technology or advanced materials sectors, lower thresholds apply until 4 January 2022 when the National Security and Investment Act enters into force. For further details see our UK merger control Quickguide.

Voluntary regime

The UK regime is a voluntary regime which means that there is, in principle, no obligation to notify the CMA for prior approval of the takeover. Transactions caught by UK merger control can therefore in theory be notified before or after completion. However, the CMA has the power to review a transaction on its own initiative (even if completed), and regularly does so. The CMA also has the power to order the freeze of any further integration of a completed merger which it is reviewing, freeze an anticipated merger and even reverse any integration steps which have been taken.

In a takeover context, a number of factors usually militate in favour of making a voluntary notification to the CMA where the transaction falls within the scope of the UK regime and could raise competition issues. Most importantly, the potential impact on the offer timetable of the CMA commencing an investigation on its own initiative at a later date means that it is normally preferable to retain control over timing by notifying the CMA of the takeover and starting the statutory timetable for review (see below). In addition, the risk that the CMA could require a completed anti-competitive takeover to be unwound weighs in favour of making a voluntary notification.

Two stage process

Following a notification or the launch of an own-initiative investigation, both of which will involve a period of pre-notification discussions with the CMA, the CMA's review also involves a two-stage process:

- an initial Phase 1 investigation, at the end of which the CMA may decide to approve the transaction unconditionally or subject to conditions, or to refer it for an in-depth Phase 2 investigation. This initial review must be completed within 40 working days; and
- an in-depth Phase 2 investigation, during which a more detailed analysis will be undertaken to determine whether the takeover may be expected to result in a substantial lessening of competition in a UK market, and if so, what action should be taken to remedy it. The CMA has 24 weeks (extendable by up to 8 weeks) to prepare and publish its Phase 2 decision.

A reference for a Phase 2 investigation will also cause the takeover offer to lapse.

For further details on the UK merger control regime see our UK merger control and UK merger control: Phase 2 references Quickguides.

4. EU Merger Regulation

EU Merger Regulation thresholds

The EU Merger Regulation is enforced by the European Commission and applies to any "concentration" with a "Community dimension". For further details on when the EU merger control regime will apply see our EU merger control Quickguide.

One stop shop in the EU

If the EU Merger Regulation applies, then under the "one stop shop" rule the national merger control regimes of the individual EU member states will not apply (unless jurisdiction is transferred back to a national competition authority by the European Commission on the basis that the transaction has a specific impact on competition in a distinct market within that member state – in practice this is relatively uncommon).

Two stage process

A takeover which falls within the scope of the EU Merger Regulation **must** be notified to the European Commission following the announcement of a public bid. As a general rule, transactions notified under the EU Merger Regulation cannot be completed prior to obtaining clearance. There is an exemption which may be relied upon in the case of public bids which have been notified without delay provided the acquirer exercises no voting rights attached to the acquired shares pending clearance, but in practice this is unlikely to be used in the context of a UK public bid.

Following pre-notification discussions (which can take weeks or even months in complex cases), the European Commission's review under the EU Merger Regulation involves a two-stage process, similar to the CMA process described above:

- an initial Phase 1 investigation, which must be concluded within 25 working days (extendable to 35 working days) of the European Commission receiving a "complete" notification.
- an in-depth Phase 2 investigation, which allows the European Commission a further 90 working days (extendable to 125 working days) to investigate the competition concerns it has identified. At the end of the Phase 2 investigation the European Commission may approve the transaction unconditionally, approve it subject to conditions, or prohibit it.

5. Other merger control regimes

As noted above, a takeover may also fall within the scope of a number of other merger control regimes around the world. The rules relating to the timing of any notification, and whether completion of the takeover must be suspended pending clearance, vary from jurisdiction to jurisdiction and a case-by-case assessment must therefore be carried out. Even if it is legally possible to implement the takeover prior to obtaining merger clearance in other relevant jurisdictions, proceeding with the transaction unconditionally may place all risk of future intervention by the competition authorities on the bidder.

6. Interaction with the Code

Mandatory offer terms: lapse of offer

The previous version of the Code differentiated between offers falling within the jurisdiction of the CMA or the European Commission and those falling within the jurisdiction of another regulator. Prior to 5 July 2021, if a takeover was caught by either the UK or EU merger control regimes, the Code required the offer to lapse if either regulator commenced a Phase 2 investigation before the later of the first closing date or the date when the offer becomes or is declared unconditional as to acceptances.

Under the revised Code, all regulatory clearances are treated consistently which means that conditions relating to clearances from the CMA or the European Commission will now be subject to the same "material significance" test as other offer conditions. The previous rule continues to apply to offers ongoing at 5 July 2021 (or any offers which compete with such an offer).

Bidders are now required to set a long-stop date for a contractual offer. The offer timetable may be suspended if a condition relating to an official authorisation or regulatory clearance has not been satisfied or waived. The timetable may be suspended at the joint request of the parties, or at the request of either party if a "material" official clearance or regulatory authorisation condition has not been satisfied or waived. The Panel has also indicated that it will usually allow an offer to lapse if regulatory clearances have not been obtained by the long stop date. The offer would only not be permitted to lapse if the remedial action needed to obtain the outstanding material regulatory clearance is sufficiently clear and not of material significance.

Competition clearance conditions

On a voluntary takeover offer, a bidder will usually include a raft of conditions to the offer in addition to the acceptance condition (or the statutory scheme conditions on a scheme). These will include competition and other regulatory conditions and general conditions relating to the business of the target.

In practice, a bidder will often seek to include conditions relating expressly to:

- merger clearance in other key jurisdictions (in particular jurisdictions where notification is mandatory if the relevant thresholds are met, such as the United States and Germany); and/or
- a "sweeper" or catch-all condition which refers generally to any required regulatory clearances and approvals.

The use of such conditions will be subject to the oversight of the Panel. Merger control conditions should also be drawn to the attention of target shareholders in the firm offer announcement with a clear explanation of the circumstances giving rise to the right to invoke any such condition.

As set out above, the Code no longer distinguishes between conditions relating to approval by the CMA and the European Commission and those relating to approval by other regulators. For offers announced on or after 5 July 2021, the Panel's consent is therefore required to make fulfilment of a merger clearance condition (including those relating to the UK and the EU) subject to clearance being obtained on terms satisfactory to the bidder (the "subjectivity rule").

In addition, merger clearance conditions may only be invoked to lapse a bid if the circumstances giving rise to the right to invoke are considered by the Panel to be of material significance to the bidder in the context of the offer (the "material significance" test). This is more likely to be the case for competition clearance conditions relating to jurisdictions where notification is mandatory and there are significant sanctions for failure to notify, and/or jurisdictions where the bidder or target has significant operations.

For conditions relating to there being no Phase 2 reference by the CMA, the Panel will also consider whether the Phase 2 process would be likely to result in a serious risk of material damage to the business of the bidder or target and the utility of requiring the parties to pursue the Phase 2 process where the prospect of clearance being obtained is low.

Strategic use of pre-conditions

Where it is clear from the outset that competition concerns are likely to arise and/or the anticipated timeframe for obtaining clearance is likely to cause difficulties for the Code timetable, bidders may consider making the posting of the offer pre-conditional on competition clearance on terms satisfactory to the bidder. The Code timetable is likely to be a particular issue where a bid is hostile and agreeing an extension to the standard Code timetable with the target may not be an option. Where the offer is announced subject to such a pre-condition, the bidder will only be under an obligation to post the offer document, thereby starting the Code timetable, once the competition clearance pre-condition has been satisfied. However, it is important to be aware that the approval of the Panel will be required to include any such pre-conditions in a firm offer announcement, and the bidder will be locked into the offer terms as announced and must proceed with the original offer once the pre-conditions are satisfied.

The subjectivity rule and the material significance test will also apply and either (i) the offer must be publicly recommended by the board of the target company or (ii) the Panel must be satisfied that it is likely to prove impossible to obtain clearance within the Code timetable.

7. UK foreign investment controls

To date, there have been very limited foreign investment controls in the UK. In general, the same rules apply to takeovers of UK public companies by foreign companies as apply in the case of takeovers by UK companies.

In the context of the UK merger control regime (discussed above), the UK Government may intervene in a takeover on public interest grounds in limited circumstances. Such intervention has been relatively rate and is currently restricted to cases involving national security, media plurality, the stability of the UK financial system prudential rules or the need to combat public health emergencies.

On 4 January 2022, the National Security and Investment Act 2021 will enter into force. This will significantly strengthen the UK Government's powers to scrutinise acquisitions that could potentially harm the UK's national security. The regime applies equally to UK and foreign investors. It will have potentially significant impacts on deal timetables and deal certainty.

The regime involves a mandatory notification requirement for transactions involving the acquisition of an interest (typically at least a 25% holding) in an entity active in 17 key sectors, including military and dual use technologies, essential national infrastructure, advanced IT technologies and critical suppliers to the Government or the emergency services. There are no minimum turnover or value thresholds. For these transactions, clearance must be obtained prior to closing. The majority of transactions are expected to be cleared unconditionally within an initial 30 working day review period. However, transactions raising potential national security concerns will be subject to a further in-depth review of 30-75 working days and may be prohibited or permitted only subject to conditions.

Parties may also make a voluntary notification if they consider that their transaction may raise national security concerns. If no voluntary notification is made, the Secretary of State for Business, Energy and Industrial Strategy has the power to call in transactions for review for up to five years after the transaction takes place (reduced to six months where the Secretary of State becomes aware of the transaction). The call-in power applies to transactions that closed on or after 12 November 2020 which means the new regime is relevant to transactions which are currently being negotiated.

The Panel has indicated that clearances required under the National Security and Investment Act 2021 will always be material regulatory clearances.

8. Overseas foreign investment controls

If the target company has subsidiaries and/or significant assets or operations outside the UK, overseas foreign investment controls will also need to be considered. Failure to obtain all necessary clearances could potentially result in the takeover being unwound at a later date. By way of example:

- the Committee on Foreign Investments in the United States (CFIUS) has power to review transactions that could result in a foreign person controlling a US business, focussing on whether the transaction presents any national security risks. A takeover of a UK public company which has US subsidiaries or assets constituting a US business could potentially fall within the scope of CFIUS' jurisdiction and may require clearance to be obtained before proceeding; and
- the Australian Foreign Investment Review Board (often referred to as FIRB) examines proposals by foreign investors to undertake direct investment in Australia where specified financial thresholds are met. This could potentially include a takeover of a UK public company which has Australian subsidiaries, or assets in Australia valued above the applicable threshold.

9. Other potential regulatory issues

There are various sector-specific rules governing the acquisition of companies operating in regulated business areas, such as banking and financial services, media, telecommunications, water and energy. For example:

- under UK broadcasting legislation, a holder of a broadcasting licence must be a "fit and proper person" to hold such a licence;
- industry regulators will expect owners of businesses such as water and energy network businesses to comply with strict provisions in the entity's regulated licence, which generally include a range of management and financial ring-fence provisions; and

- any acquisition of control of a company regulated by the Financial Conduct Authority (FCA) or the Prudential Regulation Authority (PRA) in the UK requires FCA or PRA approval (as appropriate) of the change in control.

10. Overseas approvals required by the bidder

In some jurisdictions, such as China, domestic companies require approvals from domestic regulators to make investments overseas. Generally, the Panel does not allow such approvals to be included as offer conditions. Such approvals need to be obtained prior to the launch of the firm offer announcement.

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If you would like further information on this guide, please speak to your usual contact at Ashurst or one of our contacts listed below.

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