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When do debt restructurings require merger filings?

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INTRODUCTION

The recent uptick in restructuring activity as a result of Covid-19 induced corporate debt distress serves as a useful reminder that competition law considerations remain relevant. That is particularly the case in the context of debt-for-equity swaps, with lenders acquiring equity in the businesses they originally lent money to, either implemented consensually or through security enforcement.

EXECUTIVE SUMMARY

In the context of debt restructuring, lenders should consider whether the transaction could constitute an acquisition of 'control' over the borrower, which may require merger filings to competition regulators. This is important as:

- *The merger filing process may affect how quickly a restructuring can be executed*.
- *In a minority of situations, a restructuring may significantly reduce competition (e.g. if a lender obtains control of multiple companies active in the same market), with the risk that a regulator imposes significant conditions or (much more rarely) blocks the restructuring.*

WHEN IS MERGER CONTROL APPLICABLE?

Most jurisdictions have merger control legislation. It is typically applicable where a transaction involves:

- the acquisition of a specified level of "control" over a target company; and
- the target and/or the parties acquiring control exceed specified thresholds. These thresholds are usually based on revenues generated in the jurisdiction and / or globally, but may be based on market shares or assets. In calculating turnover, it is generally necessary to assess total "group" turnover of the target and the party or parties acquiring control.

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.

Some jurisdictions, for example, the UK, Australia and Singapore, operate so-called "voluntary" merger control regimes. In these jurisdictions, the transaction may lawfully be completed prior to securing merger clearance. However, there are complications in doing so. For example, in cases which raise competition concerns, deals may need to be unravelled after the event; and in the UK, the Competition and Markets Authority will invariably impose a "hold separate"/initial enforcement order if it reviews a transaction which has already completed. (See our Quickguide on UK merger control for further details.)

This briefing focuses on the types of lender rights which may amount to "control" under the EUMR. However, it is necessary to consider the potential application of merger control in any jurisdictions in which the target or parties acquiring control have revenues or assets.

HOW IS CONTROL ASSESSED?

The EUMR applies to transactions for which the turnover from sales of the "undertakings concerned" exceeds the relevant thresholds (set out in our Quickguide on EU merger control) and one or more undertakings acquire, whether by the purchase of securities or assets, by contract or otherwise, direct or indirect control of the whole or parts of at least one other undertaking.

"Control" is defined for EUMR purposes as the possibility of exercising "decisive influence" over an undertaking (in this context, the borrower). It is not necessary to show that decisive influence is actually exercised. Control must be obtained on a "lasting basis" – for example, if a lender were to obtain control of a borrower having already agreed a legally binding sale of the borrower to a third party within a year, only the ultimate acquisition of the borrower by the third party would be caught by the EUMR.

A lender could obtain control over a borrower by obtaining:

- the majority of the voting rights of the borrower;
- less than 50 per cent of the voting rights, where this provides a de facto ability to affect strategic decisions of that undertaking, e.g. where a minority shareholder would be likely to have a stable majority of the voting rights based on the number of votes actually cast at previous shareholder meetings;
- the right to manage the activities of the borrower and to determine its business policy. It is the entity which has the power to exercise control over the entity, rather than the entity that formally owns the shares that is relevant (e.g. as a general partner in a limited partnership), which is often relevant in the context of investment funds; or
- veto rights in relation to key strategic matters of the borrower such as the business plan, approval of the budget, or the appointment of senior management. In some cases, this can also include veto rights over investments, for example if the approval threshold is low and investment is an important part of the market behaviour of the borrower.

It is necessary to consider which entity/entities in reality has/have control. This may be different to the legal owner of the shares, for example for investment funds or where following an event of default a lender has the power to exercise voting rights over shares it does not own.

JOINT CONTROL BY TWO OR MORE LENDERS IS MORE LIKELY TO TRIGGER MERGER FILINGS

The acquisition of minority stakes may result in the creation of joint control whereby two or more undertakings are able to exercise decisive influence jointly and thereby share control.

Therefore, in the context of any restructuring, it is important to be aware that:

- if multiple parties are acquiring "control" of an entity, the revenue of the acquiring parties alone could be sufficient to trigger the thresholds (i.e. irrespective of borrower's revenue); and
- subsequent merger control filings may be required if the control position of the target changes (i.e. depending on the circumstances, on the entry or exit of controlling parties).

TIMING IMPLICATIONS AND POTENTIAL ALTERNATIVE OPTIONS

Under mandatory filing regimes, 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 close urgently. This challenge is particularly acute in current circumstances, as the merger control processes in various jurisdictions may be subject to significant delays, and a number of competition authorities are encouraging parties to hold off submitting their notifications where possible.

However, there are a number of ways in which the delay between signing and closing can potentially be avoided, or at least reduced. In particular:

- it may be possible to structure the transaction so that control (for merger control purposes) does not arise. This might involve the lenders obtaining more limited rights; or

- alternatively, under the EUMR a derogation can be sought from the obligation not to complete the transaction prior to clearance in the EU. Derogations have in the past been granted where there has been a high risk of insolvency of the target (i.e. borrower) occurring within the timescale of the usual EUMR process. Similar mechanisms are also available in other jurisdictions. Where a derogation is not available, it may instead be possible to obtain a clearance within an expedited timescale. For further detail, see our briefing on Merger Control in time of Crisis.

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