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Select 2020

Top 5 regulatory risks that could make or break the deal

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Agenda for session:

Areas of focus

1. Merger filings – traps for the unwary
2. The UK merger regime – voluntary in name only
3. Concerns about 'killer acquisitions'
4. Internal documents – greater disclosure requirements
5. Brexit – transition period & beyond

Merger filings

Gun-jumping and other traps for the unwary

Merger filings – traps for the unwary

Upfront risk/timing assessment to deal with notable uptick in global merger enforcement

- 125+ merger control regimes around the world; majority require qualifying mergers to be:
  - notified to relevant authority; and
  - suspended (not implemented) prior to formal clearance
- Big uptick globally in sanctions for non-compliance for:
  - failure to notify and
  - 'gun-jumping'
- High-profile investigations and significant fines in Europe – eg *Altice/PT Portugal* (€124.5m fine); *Canon/TMS (*€28m fine for 'warehousing' structure); numerous UK fines for breaches of IEOs
- Sanctions in EU and US for non-competes (eg *Telefónica/Portugal Telecom* in EU; *DTE Energy/Enbridge/NEXUS* in US); focus on non-solicitation provisions

Merger filings – traps for the unwary

Unlawful pre-clearance conduct

- Substantive 'gun-jumping': Prior to closing, competitors must not coordinate commercial conduct whilst still legally independent – breach of competition rules on anticompetitive conduct.
- Procedural 'gun-jumping': Merging parties must suspend closing pending clearance, regardless of whether they compete or not.
- Tension between compliance with 'standstill' obligations and legitimate desire for parties to prepare for post-merger integration as early and as effectively as possible – eg *EY/KPMG Denmark*
- Conduct short of taking formal ownership over target shares/assets – measures construed as transferring 'beneficial ownership' prematurely – eg *Altice/PT Portugal*
  - Exercise of rights set out in SPA aimed at preserving value – deemed to go beyond what was necessary, giving possibility of exercising decisive influence prematurely
  - Exchange of sensitive information (extensive and granular) deemed unnecessary/unwarranted and carried out without safeguards – permitting inappropriate insights into competitor's activity whilst still legally independent

The UK merger regime

Voluntary in name only

The UK merger regime – voluntary in name only

Expansionist and muscular agenda of CMA already evident pre-Brexit

- CMA power to call in non-notified transactions up to 4 months post-closing/announcement whichever is the later and even to push into in-depth Phase 2, eg *Amazon/Deliveroo, Sabre/Farelogix*
- Although parties free to close a transaction over a pending CMA investigation, will be subject to very stringent hold-separate/freeze requirements (IEOs), with potentially sizeable fines for failure to comply
- Lower '*material influence*' threshold for establishing a '*qualifying*' merger, eg *Amazon/Deliveroo*
- Highly flexible '*share of supply*' test to assert jurisdiction over mergers with very small increments, eg *Illumina/PacBio,* or even where the parties say that there are no UK sales, eg *Roche/Spark, Sabre/Farelogix*

The UK merger regime – voluntary in name only

CMA record as most aggressive merger enforcer in 2019

- Concern that the CMA expanding jurisdiction to review transactions where it has *prima facie* concerns on substance or where it has concerns about past under-enforcement
  - Focus on consumer facing products; pharma; innovative technology
- CMA more dynamic in identifying 'counterfactual ' against which the competitive impact of the merger is assessed, going beyond the *status quo ante* to look at what would have happened absent the merger, eg if the target had been acquired by an alternative purchaser presenting fewer competition concerns
- In 2019 CMA intervention saw 3 deals prohibited (*Sainsbury's/Asda, Tobii/Smartbox, Illumina/Pacific Biosciences)* and 5 deals abandoned
- Fines for procedural breaches including of IEOs and RFIs exceeded £770,000 (cf £20,000 in 2018)

Killer acquisitions

And other concerns about loss of competition in innovation

Protecting competition in innovation

Challenges for merger control

- Deals under the spotlight in fast-moving and/or innovation-driven industries:
  - Concerns about 'under-enforcement'
  - Do competition authorities have the right tools to review them properly
- Pharma industry consolidation:
  - Incumbent firms buying out development products that pose a future competitive threat
  - Study shows discontinuation of pipeline products in 6% of US pharma deals
- Tech sector in focus especially:
  - Part of broader concerns about incumbent platforms with unassailable market positions
  - Winner-takes-all markets, levels of concentration too high, big data as an asset

Protecting competition in innovation

Challenges for merger control (cont.)

- Broader focus on how best to gauge impact of deal on competition in innovation
- More interventionist approach already shown by the European Commission
- Recent *Dow/DuPont* agri-chemicals merger:
  - Assessment not confined to whether there is harm to innovation on a specific product market in which parties are developing similar products
  - Instead, a general assessment of harm to innovation across the industry, eg reduced overall R&D spend in pesticides

Protecting competition in innovation

Particular concerns about killer acquisitions

- Incumbents purchase smaller potential competitors at early stage:
  - Allegedly to kill off disruptive (future) offerings, and in tech to deter users from migrating away from incumbents' ecosystems
- Concern about acquisitions escaping scrutiny:
  - Start-up targets too small to trigger review thresholds
  - Significance of merger not appreciated – substantive issues not fully taken into account
  - But is there evidence to support this concern?
- And, if so, how should the problem be addressed:
  - Innovation may be impeded by early purchase of innovators
  - But prospect of buyout a driver for start-ups; heightened regulatory scrutiny risks chilling that innovation

Protecting competition in innovation

Potential regulatory responses

- Lower the jurisdictional thresholds for review:
  - Current thresholds most often based on size of parties' turnovers – deals not caught if target has low or no revenues
  - Introduction of additional thresholds based on deal value (eg Germany and Austria)
  - Mandatory notification of all acquisitions by large companies
  - Prohibit the largest companies from making any further acquisitions
- Deeper assessment:
  - Consider a longer time frame for assessing effects of merger
  - Dawn raid powers to help gather internal documents

Protecting competition in innovation

Potential regulatory responses (cont.)

- Change standard of proof:
  - Suggestion in UK for 'balance of harm' test rather than 'balance of probabilities' – to catch low probability, high impact competitive detriment
- Reverse burden of proof:
  - Dominant firms have to demonstrate that merger is pro-competitive, rather than authorities demonstrating that it is anti-competitive
- Improve general understanding of these markets:
  - CMA market study on online platforms and digital advertising


Internal documents
Greater disclosure requirements

Internal documents - greater disclosure requirements

Regulators' point of view

- Seismic shift in Europe towards greater requirement for document disclosure during merger reviews alongside very extensive upfront merger notification forms
- *Dow/DuPont* EC decision contained more than 1000 references to internal docs – key evidence, particularly in 'killer acquisition' cases
- In UK CMA CEO referred to rise in UK merger prohibitions as partly arising from richer evidence-gathering through internal documents, deal-evaluation materials as well as third-party evidence
- Particular probative value for checking claims/key competitive effects – eg strategic rationale, post-merger plans/incentives, closeness of competition and other relevant considerations
- Other authorities in international mergers regularly ask to see documents disclosed in other jurisdictions.
  - Can create strategic considerations in multi-jurisdictional filings (eg in Brazil very little redaction permitted)

Internal documents -greater disclosure requirements

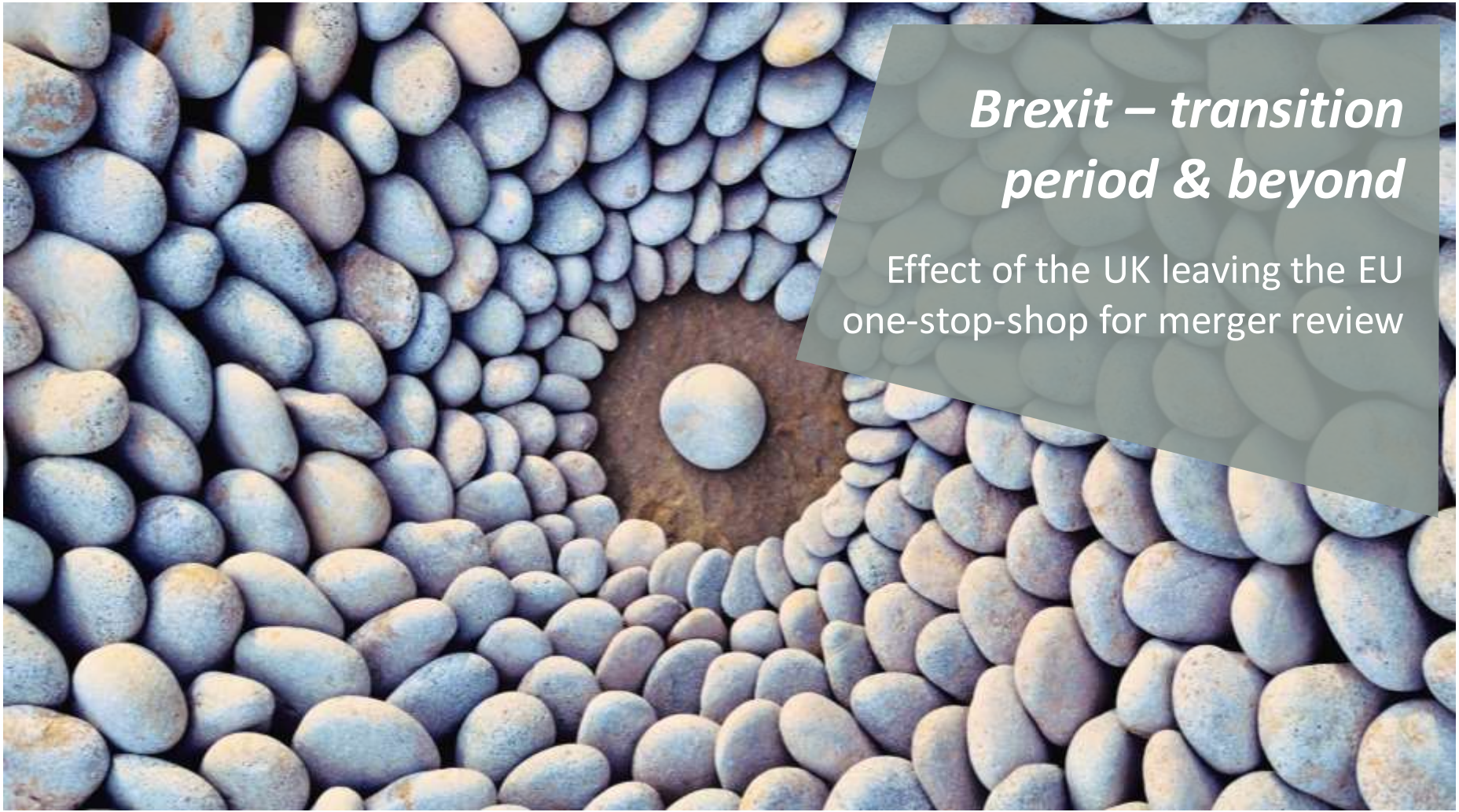
Concerns of merging parties

- Documents requested within tight timeframes and with short notice – risk of inadvertent privilege waiver/or procedural fines, eg *Sabre/Farelogix* UK fine decision
- Cherry-picking of documents supporting initial (often novel) theories of harm – using targeted search terms
- Searching for 'smoking gun' – not optimal/appropriate for understanding operation of markets/industries
- Interpreting literally or without necessary context – no formal testimony about meaning, intention or relevance:
  - represent snapshots possibly overtaken by more recent developments or insights
  - may not reflect leadership-endorsed views (ie not 'mind of the company')
  - predictions may be overly optimistic and/or made at lower level of hierarchy – eg *Dow/DuPont*, indications that parties were planning to decrease R&D was based on personal views of a relatively junior scientist
- CMA increasingly considering use of witness interviews, similar to the practice of the US Department of Justice and FTC citing recent interviews conducted with Amazon's senior management in *Amazon/Deliveroo*
- Relying on regulator's good faith use and interpretation of documents but with little opportunity to rebut reliance – including in relation to 3rd party documents

Greater disclosure requirements

Going forward, how to avoid surprises and comply in time

- Current EU situation contrasts with US where process is well established, understood and largely predictable
- By contrast, EU approach is more *ad hoc* (including in pre-notification) and risks creating further burden alongside the extreme demands of EU process (rigid structure of pre-notification, extensive Form CO requirements and strict/inflexible timetables)
- EU moving to US approach on document demands but without requisite safeguards, appropriate framework or guidance (although Member States have begun producing national guidance – eg the CMA)
- Need practical changes relieving pressure on parties and allowing regulators to focus on practical/legal issues leading to higher-quality decisions
- European Commission needs to use experience from past cases to develop guidelines so parties have greater clarity on types of documents likely to be requested in pre- and post-notification
- Consider slimming down requirements of Form CO or national equivalent in favour of targeted RFIs



Brexit – transition period & beyond

Effect of the UK leaving the EU one-stop-shop for merger review

Brexit – transition period & beyond

Little change during 2020 – current rules continue

- EU Merger Regulation (EUMR) rules applicable to larger cross-border deals offer the advantage of a one-stop-shop notification process for merger control clearance across the EU
  - Where EUMR jurisdictional thresholds relating to parties' turnovers are met, the European Commission has exclusive competence to review
  - No need to file the deal with any national competition authorities across the EU 28 Member States
- For deals with an impact on UK markets, these existing rules continue to apply during the transition period to the end of this year
  - Parties' UK revenues included when assessing whether EUMR turnover thresholds are met
  - If they are, the Commission retains exclusive jurisdiction so CMA does not review

Brexit – transition period & beyond

From start of 2021 onwards, potential parallel review in the EU and the UK

- After transition period ends, EUMR no longer applies to UK
- UK aspects of mergers are outside of one-stop-shop Commission jurisdiction
- CMA free to review deal in parallel, if UK jurisdictional tests met:
  - UK turnover of target over £70m; or
  - 25% UK share of supply/consumption created or increased
- May also affect the application of the EUMR in the EU 27 member states:
  - Parties' UK revenues excluded when assessing whether EUMR turnover thresholds met
  - If EUMR thresholds not met, deal instead exposed to national regimes across the EU

Brexit – transition period & beyond

Deals straddling the year end

- Whether UK aspects of deals ongoing around the year end are subject just to EUMR jurisdiction or also exposed to parallel UK review will be determined by reference to the date of notification to the Commission:
  - Mergers filed in Brussels before 31 December 2020 – CMA not able to review
  - Mergers filed in Brussels after 31 December 2020 – CMA may review
- But still some jurisdictional uncertainty about impact on application of EUMR for deals signed this year but not filed in Brussels before 31 December 2020:
  - Will Commission assess whether EUMR jurisdictional thresholds are met by reference to date of the agreement (ie before the year end) – and therefore include parties' UK revenues
  - Or will it assess this by reference to date of notification (ie after the year end) – and therefore exclude parties' UK revenues

Brexit – transition period & beyond

As the year end approaches

- How should parties handle this:
  - Incentives to file EUMR notification in Brussels before the year end in order to avoid burden of parallel UK review
  - But timing of notification not always solely in parties' control and may be risks in rushing process in front of Commission
- Where material likelihood that EUMR deal will not be formally notified in time before the year end:
  - Parties should engage with CMA in advance as well as with the Commission
  - Parties need to take account of implications in transaction planning and documentation

Key takeaways

What are the most important points to remember?

- Upfront risk/timing assessment should be built in to merger assessment particularly for global mergers
- Watch out for 'voluntary' UK merger regime as it is a trap for the unwary
- Expect increased regulatory scrutiny of tech deals and in markets where innovation is important
- Be ready for internal document disclosure as a integral part of merger control exercise
- Beware of the Brexit effect on merger control – plan early for deals occurring around the year end

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