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Acquisition of businesses in financial difficulty as a result of COVID-19: Do buyers still need to wait for prior antitrust/competition clearance?

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In the wake of the COVID-19 crisis, many companies will be facing significant financial difficulties for which the only viable solution to remain a going concern will be acquisition by another company. It is safe to predict that there will be pressures for sector consolidation through mergers of competitors. Many of these transactions will require prior merger clearance, but for some companies it may simply not be possible to stay afloat long enough to wait for merger clearance. One option in these circumstances is to seek a derogation (waiver) from the requirement to wait for merger control clearance before completing the transaction.

This briefing explains how the derogation process works and offers some key points for purchasers of distressed businesses to keep in mind when considering whether to go down this route. We focus principally on the process under the EU Merger Regulation (EUMR) but also offer some guidance on other key jurisdictions – both at EU Member State level within the EU and outside Europe.

1. Derogations under the EU merger control regime

Under the EU merger control rules, transactions that meet the reporting thresholds prescribed in the EUMR cannot be implemented prior to obtaining competition clearance from the European Commission. This suspensory requirement is known as the "standstill obligation".[1]

The rationale for this is to safeguard the principle of *ex ante* review of transactions under the EUMR. The Commission has the power to prohibit a transaction or clear it subject to conditions where it concludes that a deal would have significant anti-competitive effects. Its ability to do this could be compromised if the parties start to integrate the respective businesses or take other steps which undermine the viability of the target on the market – hence the standstill requirement.

[1] EUMR, Article 7(1).

Failure to comply with the standstill obligation, including any integration of the respective businesses prior to completion, is treated as "gun jumping" – something which the Commission has increasingly been clamping down on in recent years through the imposition of large fines. However, the Commission has the power to grant parties to a merger a derogation from the standstill obligation.[2]

To obtain a derogation from the standstill obligation, the parties must submit a reasoned submission to the Commission. When assessing such a derogation request, the Commission will investigate: (i) the likely adverse impact of a continued suspension of the envisaged transaction on the business of the parties (as well as on third parties), and (ii) the prima facie impact of the transaction on competition. The Commission will only grant a derogation where it is satisfied that compliance with the standstill obligation will endanger the viability of one of the parties and that the transaction will not lead to irreversible harm to competition. The Commission can grant either a full derogation (i.e. allowing the transaction to complete and the parties to integrate fully) or a partial derogation (i.e. allowing only partial integration prior to receipt of merger clearance) and can make the derogation subject to conditions.

It should be noted that this is not a derogation from the requirement to obtain substantive competition clearance for the deal. Thus, parties will still need to make a filing and go through the normal Commission merger control review process.

Derogations from the standstill obligation at EU level are relatively rare. However, a situation where it may be possible to obtain a derogation is where the target is in acute financial distress. During the height of the financial crisis in 2008/09, the Commission granted more than twice the number of derogations than it has typically granted in normal years. In some of these cases the Commission granted a derogation very quickly. For example, in one case involving the acquisition of a British bank, the level of concern about the imminent collapse of the bank and the ensuing consequences for the UK economy was such that the Commission granted a derogation within a day (and on a Sunday).

Similarly, in the current COVID-19 crisis when businesses encountering serious difficulties become targets for acquisition, it is an obvious time for merging parties to consider seeking a derogation from the Commission.

For buyers involved in a transaction where the target is financially distressed, there are several issues to bear in mind before going down this route.

In what circumstances are derogations likely to be granted?

The Commission will only grant a derogation where it is satisfied that there is a genuine threat of irreversible damage to the target if the parties are required to comply with the standstill obligation. The parties will need to show that without immediate intervention the target is at real (not hypothetical) risk of going out of business.

Just as during the financial crisis wider concerns about the stability of the entire banking sector may have eased the process of obtaining derogations for bank mergers, in the context of the COVID-19 crisis the Commission may be more prepared to consider a derogation if the target company has systemic relevance for the economy and/or its demise may also have significant consequences for third parties.

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[2] EUMR, Article 7(3).

What if the transaction appears to give rise to competition concerns?

In addition to there being concrete urgency, the Commission will conduct a preliminary assessment of whether the transaction is likely to have an irreversible adverse effect on competition.

Where it believes that the transaction is likely to have significant anti-competitive effects, the Commission is unlikely to grant a derogation. Where the Commission is prepared to agree to the derogation request, it will probably attach conditions in order to ensure that it is still feasible for the Commission to block the deal if, at the end of its review, it concludes that the merger is anti-competitive. Thus, in previous cases, the Commission has required operation of the target to be ring-fenced from the rest of the buyer's business or for the buyer to maintain the *status quo* within the target (e.g. retaining senior management) until clearance is received.

For example, in 2016 the Commission granted a derogation in respect of a merger between two airlines, thus permitting the buyer to take over the target's aircraft leases. The Commission found that the transaction posed a "serious risk" to competition on a number of routes but weighed this against the fact that maintaining the standstill would "seriously and negatively affect" the parties and also third parties insofar as it would impact the target's employees, customers and creditors. The derogation was, however, conditional on the buyer ensuring that the lease contracts were assignable to a third party in the event that it decided not to clear the deal following its subsequent review.

Even where the Commission grants a derogation without comprehensive conditions attached, it is prudent for the parties, when contemplating steps to progress the transaction, to take account of the risk of the Commission blocking the deal (or imposing remedies on it in its final decision) such that the steps taken by them might need to be undone.

Are there any alternatives to going down the derogation route?

Where a target is in financial difficulty and the contemplated transaction does not cause any substantive competition concerns, it may be fairly straightforward to obtain a derogation. However, this may not necessarily be the best option – instead it may be better to obtain clearance in the normal way but using the Commission's simplified procedure where this is available.

The simplified procedure is available for cases with no substantive competition concerns (i.e. there are no markets on which competition would be affected). It allows the parties to provide less information than under the full procedure and, as such, prepare and submit the notification more quickly. In turn, the Commission may be able to issue a decision in a shorter timeframe than the 25 working days in which it formally has to do so.

The Commission may be open to granting approval more quickly than normal where exceptional circumstances arise, such as financial distress. This route may therefore sometimes be quicker than seeking a derogation from the standstill obligation and, if successful, will give the merging parties the legal certainty of a final clearance decision more quickly.

At what stage in the transaction should the question of derogation be raised?

Given the various factors to consider when applying for a derogation, it will be advisable to consider the pros and cons and what is the best approach as early as possible during transaction planning.

It can also be helpful to have early informal discussions with the Commission about these issues and, in particular, to gauge what impact the current COVID-19 crisis is having on the Commission's timing.

In addition, it may well be worth seeking political support for prominent cases involving target companies of significant importance for a Member State's economy.

2. Keep in mind other applicable merger control regimes

Many other merger control regimes, both at the EU Member State level and outside of the EU, operate mandatory notification systems with standstill obligations. For deals which need to be notified in multiple jurisdictions, companies should therefore also consider how to navigate any relevant suspensory requirements there, and how these procedures will interact with each other.

EU Member States

Within the EU, for transactions that do not meet the EUMR reporting thresholds, or which do not amount to a full merger under EU merger control laws (such as acquisitions of minority stakes or the formation of non-fully functional JVs), one or more notifications at EU Member State level may be required. The approach taken at EU Member State level is broadly similar to that under the EUMR. Below is a table summarising the main features of regimes in key EU national jurisdictions.

Country	Is it possible to obtain a derogation from the standstill obligation?	What is the test for a derogation to be granted?	How long does it normally take to obtain a derogation?	Can the derogation be partial rather than full (i.e. approval to implement only part of the merger)?	Can conditions be attached to the derogation?	How frequently are derogations granted?	Is the number of derogations expected to increase as a result of the COVID-19 crisis?
Belgium	Yes	No specific criteria in the legislation, but past practice indicates a similar approach to that of the European Commission	Derogation may be requested either before or at the time of the formal filing The BCA has 2 weeks to consider and report, but in practice usually takes 10 days or less	Yes	Yes	Derogations are not granted very often by the Belgian Competition Authority (BCA) and the number Is not usually more than 3-4 a year	Yes
France	Yes	No specific criteria in the legislation, but only granted in exceptional cases and under strict conditions Most often granted in the case of acquisitions of companies which are insolvent or companies in liquidation proceedings Other exceptional circumstances in which derogations may be granted include: the risk of imminent demise of the target; and the acquirer needing to provide collateral or obtain funding in order to maintain the target's business	Derogation may be requested either before or at the time of the formal filing, or during the review process In cases of judicial insolvency proceedings, derogation is preferably requested at least 5 working days before the court's judgment selecting the acquirer The FCA usually issues its derogation decision within 10 days, but may take longer in more complex cases If a derogation is granted, the information required for the substantive appraisal of its transaction must be provided within 3 months, otherwise the derogation becomes void	Yes	Yes	The number granted annually by the French Competition Authority (FCA) varies, but is usually not more than 10 a year	Yes

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Germany	Yes	Where the parties can demonstrate serious grounds, in particular to prevent serious harm to any party (including the target) or any third party, e.g. due to the danger of insolvency	Derogation may be requested either before or at the time of the formal filing Depending on the urgency and the timing of the request, the derogation can be granted within 2 days to a few weeks	Yes	Yes	The number granted annually by the German Federal Cartel Office (FCO) varies, but is usually not more than 5-10 a year	Instead of granting a derogation, the FCO often encourages parties to notify the transaction and commits to an accelerated review process With mergers that do not involve any substantive competition issues, the FCO can clear transactions within a very short time, even within 1-2 working days While derogations may increase due to the effects of COVID-19, accelerated review is likely to remain the preferred route for the FCO

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Italy	Not applicable – there is no automatic standstill obligation and so no need for a derogation Transactions can be closed immediately after filing, unless the Italian Competition Authority (ICA), when opening an in-depth (phase 2) investigation, makes an order to prohibit this	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Although legally permitted to close, notifying parties commonly choose not to and instead make closing conditional upon prior receipt of clearance – especially in cases which are complex or raise substantive competition issues This is in order to avoid the risk of the ICA imposing remedies post-closing, e.g. requiring divestment of the acquired business
Netherlands	Yes	There must be significant reasons Factors taken into account by the Authority for Consumers and Markets (ACM) include the financial situation of the target and the risk that not granting it may seriously jeopardise the merger	Derogation may be requested either before or at the time of the formal filing Derogation will be granted quickly, often within a few working days and sometimes even within 1 day (in 2019, the average time was 3-4 days)	Yes	Yes	The ACM grants an average of 5 derogations a year	Yes

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Poland	No However, there is an exemption from the obligation to notify (and, therefore, no standstill requirement) for transactions involving a target in the course of bankruptcy proceedings – although this exemption does not apply where the buyer is a competitor of the target or part of a corporate group that includes one	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
Spain	Yes	There must be significant reasons In considering whether to grant the derogation, the National Commission on Markets and Competition (the CNMC) will take into account the potential harm to the parties in not doing so and the potential harm to competition in allowing the transaction to proceed	Derogation may be requested either before or at the time of the formal filing Derogation will be granted quickly, within a week of formal filing of the transaction (assuming prior pre-filing contacts to this end)	Yes	Yes	To date the CNMC has been reluctant to grant derogations and has only done so in exceptional circumstances – the last 2 examples being in 2016 and 2013	Yes

Outside the EU

Outside the EU, there is a greater variety of approach. Some jurisdictions impose a standstill obligation without any procedure allowing for derogation of this requirement. At the other extreme, there are jurisdictions which operate a voluntary notification regime without any standstill obligation, although there may be other procedural obstacles to implementation of the transaction that need to be navigated. Below are some examples of differing approaches in key jurisdictions outside the EU.

Country	Is there a standstill obligation and, if so, is it possible to obtain a derogation?	Are there any other considerations parties should be aware of?
China	There is a standstill obligation for notifiable transactions – but there is no process for obtaining a derogation from the State Administration for Market Regulation	
United Kingdom	The filing regime is voluntary and there is no standstill obligation – so there is no need to seek a derogation However, where the Competition and Markets Authority (CMA) decides to investigate a transaction, it will commonly impose interim measures requiring the parties to hold their businesses separate during the review period – and will almost always do so in the case of a transaction which has closed. Further, upon reference for an in-depth (phase 2) investigation, there is an automatic prohibition on acquiring shares in a target without the CMA's consent The CMA can grant derogations from the requirements of the order if they are strictly necessary to maintain the viability of the target and there are no better alternatives available	Although legally permitted to close, notifying parties in cases which raise substantive competition issues often choose not to and instead make closing conditional upon prior receipt of CMA clearance. This is in order to avoid the risk of the CMA imposing remedies post-closing, e.g. requiring divestment of the acquired business Examples of specific derogations from interim measures granted by the CMA in previous cases in which the target has been in financial difficulties include to allow: the target to have access to the buyer's credit facilities; the buyer to give financial guarantees to the target's suppliers; the target business to deviate from its pre-merger business plans; and the buyer to have access to certain commercially sensitive information about the target Although formally the CMA does not relax its approach to derogations during times of economic difficulty, the number of cases meriting such treatment may well increase as a result of the COVID-19 crisis
USA	There is a standstill obligation: parties notifying reportable transactions are required to observe a waiting period before closing, in order to obtain clearance However, there is no process for seeking derogation from this standstill requirement	Although there is no derogation process, the waiting period is reduced to 15 days for acquisitions covered by US bankruptcy law 11 U.S.C. Section 363(b) More generally, if there are no substantive competition issues, and the parties have compelling reasons for a quick closing, they may be able to persuade the US agencies to terminate the waiting period early

3. Key takeaways

- **Derogations are only granted in exceptional circumstances and the bar remains high**

Competition authorities may well be more open to granting a derogation in the circumstances of the COVID-19 crisis, but it will still be necessary to provide them with convincing evidence that the target is in imminent danger of going out of business.

- **It is more difficult to obtain a derogation if the transaction gives rise to competition issues**

For deals that involve potentially significant competition concerns, a derogation may be refused or only granted with stringent conditions attached.

- **Derogation is not always the best option from an overall timing perspective**

In particular, it may instead be quicker and procedurally less burdensome to seek a fast-track clearance where this option is available.

- **It pays to decide early on what the best way forward is**

Where a derogation is a possibility, it is worth considering the pros and cons at the initial stages of transaction planning, and generally advisable to make early contact with the competition authorities in order to gauge their views.

Contacts

Mark Jones
Partner, London
T +44 20 7296 2428
mark.jones@hoganlovells.com

Sabrina Borocci
Partner, Milan
T +39 02 720 2521
sabrina.borocci@hoganlovells.com

Adrian Emch
Partner, Beijing
T +86 10 6582 9510
adrian.emch@hoganlovells.com

Casto González-Páramo Rodríguez
Partner, Madrid
T +34 91 349 80 37
casto.g-paramo@hoganlovells.com

Michele S. Harrington
Partner, Northern Virginia
T +1 703 610 6173
michele.harrington@hoganlovells.com

Eric Paroche
Partner, Paris
T +33 1 53 67 47 47
eric.paroche@hoganlovells.com

Falk Schöning
Partner, Brussels
T +32 2 505 0906
falk.schoening@hoganlovells.com

Piotr Skurzynski
Counsel, Warsaw
T +48 22 529 29 00
piotr.skurzynski@hoganlovells.com

Matt Giles
Senior Knowledge Lawyer, London
T +44 20 7296 2428
matt.giles@hoganlovells.com

Raphaël Fleischer
Senior Associate, Brussels
T +32 2 505 0914
raphael.fleischer@hoganlovells.com

Alfredo Gómez
Senior Associate, Madrid
T +34 91 349 81 58
alfredo.gomez@hoganlovells.com

Luigi Nascimbene
Senior Associate, Milan
T +39 02 720 2521
luigi.nascimbene@hoganlovells.com

Céline Verney
Senior Associate, Paris
T + 33 1 53 67 47 47
celine.verney@hoganlovells.com

Rachel Xu
Senior Associate, Beijing
T +86 10 6582 9439
rachel.xu@hoganlovells.com

Zoe Bartlett
Associate, London
T +44 20 7296 2159
zoe.bartlett@hoganlovells.com

Magdalena Kowara
Associate, Warsaw
T +48 22 529 29 00
magdalena.kowara@hoganlovells.com

www.hoganlovells.com