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

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.

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.

Competition analysis

At a preliminary stage of the bid process, a detailed analysis should be conducted to establish which jurisdictions may require approvals/clearances (or confirmation that no clearances are triggered). 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 the 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 4 below).

If the takeover is caught by either the EU or UK merger control regimes, the provisions of the Code relating to mandatory lapse of the offer in the event of a European Phase 2 investigation or a UK Phase 2 investigation will need to be taken into account (see section 6 below). Consideration must also be given to the impact of any notification on the offer timetable, and whether to make the offer subject to any competition clearance conditions.

EU merger regulation (EUMR)

EUMR thresholds

The EUMR is enforced by the European Commission (Commission) and applies to any "concentration" with a "Community dimension". A takeover will constitute a "concentration", and it will have a Community dimension if the relevant financial thresholds are met, as highlighted in the diagram overleaf.

One stop shop in the EU

If the EUMR 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 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).

Pre-notification

A takeover which falls within the scope of the EUMR **must** be notified to the Commission following the announcement of a public bid. As a general rule, transactions notified under the

EUMR 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 and 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.

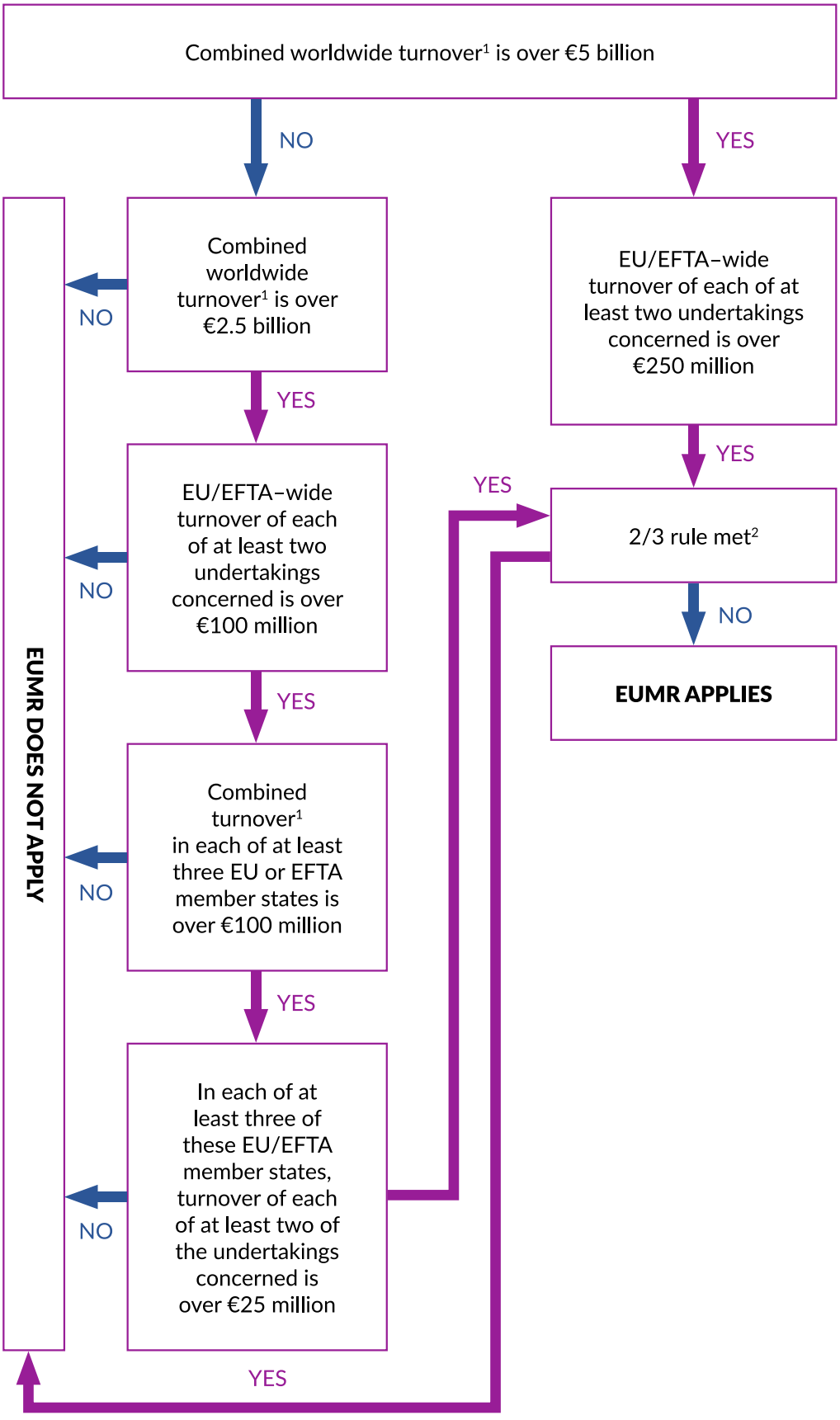
Two stage process

The Commission's review under the EUMR involves a two-stage process:

- an initial Phase 1 investigation, at the end of which the Commission may either approve the transaction (conditionally or unconditionally), or, if serious competition concerns have been identified, initiate an in-depth Phase 2 investigation. This initial investigation must be concluded within 25 working days (extendable to 35 working days) of the Commission receiving a "complete" notification. It is important to be aware that it can take weeks (or even months, in complex cases) to agree the notification with the Commission before the clock officially starts to run; and
- an in-depth Phase 2 investigation, which allows the 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 Commission may approve the transaction unconditionally, approve it subject to conditions, or prohibit it.

Initiation of a Phase 2 investigation by the Commission will cause a takeover offer to lapse under the Code (see section 6 below).

EUMR thresholds



1 All "undertakings concerned" (e.g. entities within each of the purchaser(s)' and target's groups).

2 Each of the undertakings concerned achieves more than two thirds of its aggregate EU-wide or EFTA-wide turnover within one and the same member state.

For further details on the EU merger control regime see our EU merger control Quickguide.

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 in the UK (or a substantial part of the UK) of goods or services will be created or enhanced.

If the transaction is in one or more of the military and dual-use, multi-purpose computing hardware or quantum technology sectors, lower thresholds apply. 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 UK's Competition and Markets Authority (CMA) for prior approval of the takeover. Transactions caught be UK merger control can therefore in theory be notified before or time after completion. However, the CMA has 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. 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, and the Code requirement that the offer will lapse if the takeover is referred for a Phase 2 investigation (see section 6), also weigh in favour of making a voluntary notification.

Two stage process

Following a notification or the launch of an own-initiative investigation, 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.

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.

In practice, a bidder will therefore 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.

As discussed in section 6, the use of such conditions will be subject to the oversight of the Panel.

Bespoke regulatory or non-EU/UK merger control conditions should 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.

Interaction with the Code

Mandatory offer terms: lapse of offer

The Code requires that where an offer falls within the scope of either the UK or EUMR merger control rules, it must be a term that the offer will lapse if either:

- there is a UK Phase 2 investigation (including following a transfer of jurisdiction from the Commission back to the CMA); or
- a Phase 2 investigation is initiated by the Commission,

before the later of the first closing date or the date when the offer becomes or is declared unconditional as to acceptances. Where a takeover is structured as a scheme of arrangement, the bid will lapse if the Phase 2 investigation is initiated before the date of the shareholder meetings to approve the scheme.

Competition reference period

If a Phase 2 investigation is initiated by the CMA or Commission, the bidder will be subject to a range of restrictions pending the conclusion of the investigation (known as the "competition reference period"). These include restrictions on the acquisition of shares of the target company and on making statements which raise or confirm the possibility that an offer might be made.

If the takeover is ultimately approved by the Commission/CMA following a Phase 2 investigation (either unconditionally or subject to conditions), the bidder will then normally have 21 days within which it must either:

- make a new offer for the target (on the same terms in the case of a mandatory bid); or
- declare that it is not making an offer (in which case it cannot make a new offer within six months).

It is worth noting that the commencement of a Phase 2 investigation does not indicate that the takeover will be blocked. Outright prohibition is relatively uncommon and more than half of Phase 2 mergers are ultimately cleared unconditionally in the UK, and around one-third at EU level.

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 addition to the mandatory term regarding lapse of the offer in the event of a Phase 2 investigation, a bidder will usually include a condition relating to a decision that there will be no UK Phase 2 investigation and/or no EU Phase 2 investigation, or that a Phase 1 clearance decision is taken by the relevant authority on terms satisfactory to the bidder. This is an exception to the usual rule that a bidder is not allowed to include subjective conditions to its offer (the subjectivity rule). It means that the bidder could invoke an EU/UK merger control condition to lapse its bid, if satisfaction of the relevant condition would require the bidder to accept unpalatable remedies (e.g. where they would undermine the commercial rationale of the deal).

As noted above, a bidder will also often wish to make an offer subject to conditions relating to merger control clearances in jurisdictions other than the EU or UK, particularly where the

takeover falls within the scope of another merger control regime which requires mandatory notification (such as the United States or Germany). However, any such competition conditions will be subject to a number of restrictions under the Code:

- the subjectivity rule referred to above will apply which means that a bidder would need to seek the consent of the Panel to make fulfilment of a non-EU/UK merger clearance condition subject to clearance being obtained on terms satisfactory to the bidder; and
- such 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. However, there is no guarantee that a bidder will be allowed to invoke such a condition, and the Panel will not provide a ruling in advance as to whether such a condition will be capable of invocation or not. The material significance test does not apply to EU/UK merger clearance conditions.

Strategic use of pre-conditions

Where it is clear from the outset that a Phase 2 investigation by the CMA or Commission is likely and the bidder is prepared to go through an in-depth merger control investigation, one possible strategy to consider is making the posting of the offer pre-conditional on competition clearance by the CMA/Commission (either at Phase 1 or Phase 2) on terms satisfactory to the bidder.

Where the offer is announced subject to such a pre-condition, the bidder will only be under an obligation to post the offer document (which kick-starts the strict Code timetable) once the competition clearance pre-condition has been satisfied.

The same strategy may also be used for other merger control clearance conditions where competition concerns are considered likely to arise and/or the anticipated timeframe for obtaining clearance is likely to cause difficulties for the strict Code timetable. This is likely to be a particular issue where:

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 Guide to Takeovers or please speak to one of the contacts listed below, or your usual Ashurst contact.

- the bid is hostile; and
- agreeing an extension to the standard Code timetable with the target is not an option.

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. This exposes the bidder to the risk of changes occurring in the target business or market conditions during the lengthy Phase 2 investigation process.

In addition, for non-EU/UK merger control pre-conditions, the subjectivity rule and the material significance test will apply, and either:

- the offer must be publicly recommended by the board of the target company; or
- the Panel must be satisfied that it is likely to prove impossible to obtain clearance within the Code timetable.

UK foreign investment controls

There are 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. However, there are a number of potential restrictions of which foreign entities should be aware:

- in the context of the EU and UK merger control regimes (discussed above), the UK Government may intervene in a takeover on public interest grounds in limited circumstances. Whilst there has been considerable recent debate about the extent to which national interests need to be protected against foreign takeovers, such intervention is relatively rare, and is currently restricted to cases involving national security, media plurality, or the stability of the UK financial system/prudential rules;
- in the case of any takeover of an entity operating an airline within the EEA, it is a requirement that any such entity must be majority-controlled and effectively controlled by EEA states or their nationals; and
- the UK Government acquired "golden shares" in a small number of UK companies in the 1980s and 1990s where it felt it needed to protect the business from takeover, for example, on national security grounds. Typical golden share powers include the ability to prevent a foreign investor from acquiring more than 15 per cent shareholding in the company and/or restrict the disposal of material assets. However, the number of golden shares has decreased significantly in light of questions over their compatibility with EU law regarding free movement of capital, and this will only rarely be a relevant consideration.

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. These can be much more extensive than the controls under UK law, and 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. It should be noted that CFIUS clearance can take a long time; 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. Again, this could potentially include a takeover of a UK public company which has Australian subsidiaries, or assets in Australia valued above the applicable threshold. The relevant thresholds vary depending on the nationality of the acquirer, currently starting at AUD $252 million.

Other potential regulatory issues

The possibility of intervention by the UK Government on public interest grounds (see section 7) also applies in the context of a takeover of a UK public company by a UK company.

In addition, 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.

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.

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 Guide to Takeovers or please speak to one of the contacts listed below, or your usual Ashurst contact.

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