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Increased scope for intervention in takeovers of UK businesses?

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Overview

Two days before her appointment as Prime Minister, Theresa May delivered a speech that has been widely received as a signal that the new Government will be more inclined to intervene in cross-border takeovers to protect UK national interests:

"*Because as we saw when Cadbury's – that great Birmingham company – was bought by Kraft, or when AstraZeneca was almost sold to Pfizer, transient shareholders – who are mostly companies investing other people's money – are not the only people with an interest when firms are sold or close. Workers have a stake, local communities have a stake, and often the whole country has a stake. It is hard to think of an industry of greater strategic importance to Britain than its pharmaceutical industry, and AstraZeneca is one of the jewels in its crown. Yet two years ago the Government almost allowed AstraZeneca to be sold to Pfizer, the US company with a track record of asset stripping and whose self-confessed attraction to the deal was to avoid tax. A proper industrial strategy wouldn't automatically stop the sale of British firms to foreign ones, but it should be capable of stepping in to defend a sector that is as important as pharmaceuticals is to Britain.*"[1]

On a similar theme, following its decision to proceed with the construction of a new nuclear power station at Hinkley Point C in England, the UK Government's Department for Business, Energy & Industrial Strategy (DBEIS) recently announced that it will "*impose a new legal framework for future foreign investment in Britain's critical infrastructure*".[2]

Notwithstanding the Prime Minister's speech and DBEIS's subsequent announcement, a number of avenues already exist under the UK legal regime to allow the Government to intervene in M&A transactions on public interest grounds. To date, these have been used only in very limited circumstances.

1 "*We can make Britain a country that works for everyone*", speech by Theresa May, 11 July 2016 (available at http://press.conservatives.com/post/147947450370/we-can-make-britain-a-country-that-works-for).

2 "*Government confirms Hinkley Point C project following new agreement in principle with EDF*", Department for Business, Energy & Industrial Strategy press release, 15 September 2016 (available at https://www.gov.uk/government/news/government-confirms-hinkley-point-c-project-following-new-agreement-in-principle-with-edf). .

However, the ability of the UK Government to intervene to protect domestic 'strategic interests' of the kind identified by the Prime Minister is currently constrained by EU merger control laws, as well as EU laws guarding the free movement of capital and freedom of establishment, constraints that (in contrast to the debates at the time of the *Kraft/Cadbury* and *Pfizer/AstraZeneca* deals) were conspicuous by their absence in the Prime Minister's speech.

This note provides a brief overview of the existing position under EU law and considers how that may change following Brexit. As with many other questions, this will depend on the model of Brexit adopted: if the UK leaves the EU but remains a member of the EEA, those same EU laws will continue to apply and there would be no material change (albeit the UK Government may feel more empowered politically to 'push the envelope' of permissible intervention). Conversely, if the UK exits both the EU and the EEA then those restrictions would fall away. In that scenario, acquisitions of businesses in strategic sectors meeting UK and EU merger control thresholds may be faced with three parallel reviews: on competition grounds in both Brussels and London and potentially also on the basis of an expanded UK public interest regime. Regardless of the terms of Brexit, however, it would seem likely that the UK will want to continue its existing policy of cooperation with other competition authorities in the vast majority of cross-border M&A transactions so as to avoid divergent merger control outcomes.

Public interest interventions under UK merger control rules

The ability of the UK Government to intervene in an acquisition of a UK-based business is primarily governed by merger control rules, ie the provisions of the EU Merger Regulation (**EUMR**) and the Enterprise Act 2002 (**EA02**). As discussed in more detail below, however, such interventions are also subject to EU rules on free movement of capital and freedom of establishment set out, respectively, in Articles 63 and 49 of the Treaty on the Functioning of the European Union (**TFEU**).

Under Article 21(3) EUMR the UK is prohibited from applying national legislation on competition to any transaction that falls within the merger control jurisdiction of the European Commission (the **Commission**). Notwithstanding that general prohibition, Article 21(4) EUMR allows EU Member States to put in place measures protecting 'legitimate interests' (other than those relating to competition) which are compatible with the general principles and other provisions of EU law. Public security, media plurality and prudential rules are expressly identified in the EUMR as legitimate interests for these purposes, while Member States may put in place measures to protect other interests provided they are first notified to and approved by the Commission.

Within these parameters of EU law, at the UK level the Secretary of State (**SoS**) may intervene in a merger under the EA02 in one of three scenarios:

a) in relation to a transaction that satisfies the merger control jurisdictional thresholds for the Competition and Markets Authority (**CMA**) to investigate and subsequently refer for a 'Phase 2' in-depth review;

b) in relation to a transaction that does not satisfy the jurisdictional thresholds for the CMA to investigate, but which involves:

   i) a relevant government contractor; or

   ii) an entity accounting for at least 25% of the supply of newspapers in the UK or in a substantial part of the UK; or

   iii) an entity accounting for at least 25% of the provision of broadcasting in the UK or in a substantial part of the UK; or

c) in relation to a transaction that is subject to merger control review by the Commission under the EUMR and in respect of which the SoS is considering whether to take appropriate measures to protect legitimate interests under Article 21(4) EUMR.

The substantive public interest grounds on which the SoS may intervene under the EA02 are set out in the text box below ('Existing grounds for UK intervention'). In addition, the SoS may by order[3] add further public interest considerations not currently specified in the EA02 – as he did in relation to maintaining stability of the UK financial system at the time of the *Lloyds/HBOS* acquisition.

[3] Any such order must be approved by both Houses of Parliament within 28 days.

To date, however, these powers have been used only in very limited circumstances: in total, the SoS has intervened under the EA02 in just six mergers on grounds of national security, one on grounds of financial stability (the proposed acquisition by Lloyds of HBOS) and three on grounds of media plurality ((a) Sky's proposed acquisition of a 17.9% stake in ITV, (b) News Corporation's (as it then was) proposed acquisition of Sky, and (c) Global Radio Group's (**GRG**) acquisition of the Guardian Media Group (**GMG**) radio channels). With the exception of *GRG/GMG*, the authors of this note have advised merging parties in relation to all of the non-defence interventions made to date under the EA02.

Existing grounds for UK intervention

- National security (including, but not limited to, defence and expressly including 'public security' as defined in Article 21(4) EUMR).
- The need for accurate presentation of news and free expression of opinion in newspapers.
- The need for a sufficient plurality of views in newspapers.
- The need for a sufficient plurality of persons with control of media enterprises.
- The need for a wide range of broadcasting which is both of high quality and calculated to appeal to a wide variety of tastes and interests.
- The need for persons carrying on / controlling media enterprises to have a genuine commitment to the attainment of broadcasting standards objectives.
- Maintaining the stability of the UK financial system (although expressly excluding an intervention on this ground where the transaction falls within the jurisdiction of the Commission under the EUMR).

The (long-running) political debate on Government intervention in cross-border M&A

The appropriate degree of UK Government intervention in cross-border M&A transactions is a political debate that pre-dates the adoption of the existing merger control regime.

Arguing in favour of the EA02's largely competition-based substantive merger control test (as opposed to the broader public interest tests contained in the EA02's predecessor, the Fair Trading Act 1973), Vince Cable, for example, stated in a Parliamentary debate that "*It is right that we should move away from the vague public interest test to a competition test.*"[4] However, calls for greater Government intervention began to increase in the wake of Kraft's takeover of Cadbury – alluded to in Mrs May's speech. In particular, following that takeover Dr Cable subsequently urged Parliament that "*We ought to have a public interest test again…the pendulum has swung too far*".[5] In response, the then SoS Peter Mandelson argued instead that "*Some people have…suggested that we need a new form of public interest test to guard British companies against foreign acquisition. I am happy to have an open debate about this, but I think we need to be very cautious. Britain benefits from inward investment and an open market for corporate control internationally. A political test for policing foreign ownership runs the risk of becoming protectionist, and protectionism is not in our interests.*"[6]

The political debate was rekindled in the UK at the time of Pfizer's bid for control of AstraZeneca. Amid concerns that the transaction would adversely affect AstraZeneca's UK R&D facilities, in an open letter to the Prime Minister the then leader of the UK opposition, Ed Miliband, stated that: "*We all recognise that takeovers are an essential part of a functioning economy and can lead to greater efficiencies and better services for consumers. However we also all recognise that too often in recent years major takeovers have failed to deliver the promised benefits…we need to look again at the UK's takeover regime. In particular there should be a stronger public interest test which encompasses cases such as these where strategic elements of our science base, with impacts well beyond the firm concerned, are involved.*"[7] Following both *Kraft/Cadbury* and *Pfizer/AstraZeneca*, the Takeover

4 House of Commons Debate, 10 April 2002, at column 66 (available at http://www.publications.parliament.uk/pa/cm200102/cmhansrd/vo020410/debtext/20410-15.htm).

5 "*Public interest test for takeovers should be reintroduced, says Vince Cable*", The Guardian, 10 February 2010 (available at https://www.theguardian.com/business/2010/feb/10/vince-cable-test-takeovers-public-interest).

6 "*One year on*", Mansion House speech by Lord Mandelson, 1 March 2010 (available at http://webarchive.nationalarchives.gov.uk/20100304014526/http://www.bis.gov.uk/mansion-house-speech).

7 Letter from Ed Miliband to the Prime Minister on the proposed takeover of AstraZeneca by Pfizer, 4 May 2014 (available at http://press.labour.org.uk/post/84701821654/ed-miliband-letter-to-david-cameron-on-proposed).

Panel tightened certain rules applicable to bidders, including the introduction of a new regime to hold parties to the type of industrial commitments offered by Pfizer. However, we would not expect the Panel to implement and police a public interest (or similar) regime in UK takeovers as this would be seen as a matter for legislation and the CMA to administer.

Existing limitations on UK Government intervention

As noted above, where a merger meets the jurisdictional thresholds of the EUMR, EU Member States are prevented from reviewing that transaction under national competition laws. However, Article 21(4) EUMR allows Member States to review those mergers in parallel where doing so is deemed necessary to protect one or more of the three legitimate interests expressly identified in that Article. Article 21(4) EUMR also envisages that the Commission may approve additional legitimate interests, upon prior notification by Member States, which are compatible "*with the general principles and other provisions of Community law*". In the *Lyonnaise des Eaux / Northumbrian Water*[8] merger in 1995, for example, the UK authorities successfully invoked this provision to enable them to review the impact of a water merger falling within the EUMR on the ability of the sector regulator to carry out its regulatory functions. In relation to mergers that are subject to the exclusive jurisdiction of the Commission on competition grounds, to take the example cited by the Prime Minister, the question is therefore whether the UK Government could intervene under Article 21(4) EUMR to "*defend a sector that is as important as pharmaceuticals is to Britain*".

In relation to mergers that fall outside the Commission's jurisdiction under the EUMR, however, there is no such constraint and the issue is instead whether other European laws (in particular in relation to the freedom of establishment and the free movement of capital) would prevent the UK Government from including one or more additional public interest considerations under section 58 EA02 in the context of a UK merger control review.

Similar questions were put to Dr Cable by the House of Lords Select Committee on Economic Affairs in July 2014 following the withdrawal of Pfizer's bid for AstraZeneca. Dr Cable responded that "*it depends entirely how such a public interest test was framed. It would indeed have to avoid the scope for capricious activity by Ministers, and crucially it would have to be capable of being accommodated within the European framework, otherwise it would have no legal force.*"[9]

With respect to the applicable "*European framework*" in this context, the EU's Court of Justice (the **Court**) has repeatedly held that interventions by EU Member States to block or impose conditions on the acquisition of assets or businesses deemed to be strategically important may constitute a violation of: (i) the Commission's exclusive jurisdiction under Article 21 EUMR to review mergers on competition grounds; (ii) the free movement of capital provisions set out under Article 63 TFEU; and/or (iii) the freedom of establishment provisions set out under Article 49 TFEU. Importantly, the Court has interpreted the EU laws in each of these three separate but related areas as applying to national laws requiring Member State approval of acquisitions of domestic assets or businesses, whether or not those requirements are expressed to bite only on investments by 'foreign' entities. Further, while the EU rules on both free movement of capital and freedom of establishment are subject to specific exceptions (e.g., on grounds of public security), those exceptions have been interpreted narrowly by the Court and have been held not to apply to Member State interventions in mergers on the basis of a generic public interest test. In particular, when considering the application of exceptions to the rules prohibiting restrictions on free movement of capital the Court has held that "*the general financial interests of a Member State cannot constitute adequate justification.*" [10]

Likewise, in the context of assessing interventions by EU Member States purportedly for the protection of legitimate interests under the EUMR, both the Commission and the Court have stressed that – in

[8] Case No. IV/M.567, *Lyonnaise des Eaux / Northumbrian Water*, 21 December 1995.

[9] "*Foreign takeovers and the public interest*", Transcript of evidence taken before The Select Committee on Economic Affairs, 8 July 2014 (available at http://www.parliament.uk/documents/lords-committees/economic-affairs/Foreign-takeovers-public-interest/cEAC20140708Ev2.pdf).

[10] Case C-367/98, *Commission of the European Communities v Portuguese Republic*, Judgment of the Court of 4 June 2002, at paragraph 52.

addition to the need for Member States to observe the prior notification obligations under Article 21(4) EUMR – such measures must be compatible with the general principles and other provisions of Community law, including those relating to the free movement of capital and freedom of establishment. An example of the Commission's approach to enforcement in this context is set out in the text box below ('The Commission's approach to legitimate interests under Article 21(4) EUMR: E.ON/Endesa').

The Commission's approach to legitimate interests under Article 21(4) EUMR: E.ON/Endesa

On 21 February 2006 E.ON announced its intention to acquire the entire issued share capital of Endesa (the Acquisition). The Acquisition was subsequently notified to the Commission under the EUMR on 16 March 2006 and cleared on 25 April 2006. However, a few days after E.ON announced its bid (and without prior notification to the Commission) Spain adopted a new legislative measure (the Royal Decree) stipulating that the acquisition by any company of more than 10% of the share capital in a company active in a regulated sector (including transport and the distribution of gas and electricity) was to be subject to prior notification to and approval by the Spanish energy regulator, the CNE. In considering whether to approve such an acquisition, the CNE was required to have regard (inter alia) to the protection of the public interest in the energy sector and public security. On 27 July 2006, the CNE subsequently adopted a decision that cleared the Acquisition subject to nineteen conditions, including that E.ON must maintain Endesa's registered office and board of directors in Spain and that, for a period of ten years from the date of completion, E.ON must not re-organise or dissolve any of the Endesa group companies.

On 26 September 2006, the Commission adopted a decision (the Decision) that Spain had infringed Article 21 EUMR on the basis that: (i) it had implemented the Royal Decree without prior notification to and approval from the Commission; and (ii) the conditions imposed by the CNE under the Royal Decree were contrary to EU laws on the free movement of capital and the freedom of establishment.[11] The Decision noted that under established EU case law, public security interests may only be cited in justification for a derogation from the principles of free movement of capital and freedom of establishment if there is a "genuine and sufficiently serious" threat to a fundamental interest of society and that Spain had failed to provide any evidence of such a threat. The Decision required Spain to withdraw without delay the conditions imposed by CNE under the Royal Decree.

Spain failed to do so and, following a second infringement decision on 20 December 2006, the Commission referred Spain to the Court on 11 April 2007. In its judgment of 6 March 2008,[12] the Court upheld the Commission's Decision.

Impact of Brexit

As noted above, the ability of the UK Government to intervene in cross-border mergers to protect domestic 'strategic interests' is currently constrained by EU merger control laws, as well as EU laws guarding the free movement of capital and freedom of establishment. As with many other questions, the extent to which this would change post-Brexit will depend on the model of Brexit adopted. If the UK leaves the EU but remains a member of the EEA, for example, those same EU laws will continue to apply and there would be no material change to the legal position (albeit the UK Government may feel more empowered politically to 'push the envelope' of permissible intervention than it has to date). Conversely, if the UK exits both the EU and the EEA then those restrictions would fall away. In that scenario, the scope of UK Government intervention in a cross-border merger may depend on the terms of post-Brexit bilateral trade and investment agreements between the UK and its trading partners (including, but not limited to, the EU) and could potentially therefore differ depending on the relevant acquirer's country of origin.

As to the form of any post-Brexit legislative changes required to empower the UK Government to make such interventions, it is worth noting that under section 13 of the Industry Act 1975 (which has never been used but, perhaps somewhat surprisingly, remains in force) the SoS formally has the power to block an acquisition of

[11] Case COMP/M.4197, *E.ON/Endesa*, 26 September 2006.

[12] Case C-196/07, *Commission of the European Communities v Kingdom of Spain*, Judgment of the Court of 6 March 2008.

an "*important manufacturing undertaking*" where such an acquisition would be contrary to the interests of public policy, public security or public health in the UK or a substantial part of it. [13] While it is possible that the UK could seek to rely on that provision post-Brexit to protect the kind of strategic interests referred to in the Prime Minister's speech, given the substantial body of case law and practical experience that has since been developed under the EA02, it would seem more natural for the Government to do so by expanding the scope of the EA02's existing public interest regime – which would, in any case, need to be amended following Brexit to repeal provisions reflecting the limitations currently imposed by the EUMR. However, a removal of the EU law restrictions on the ability of the UK Government to intervene in mergers on public interest grounds would not, in and of itself, bring about a more aggressive use of such powers. In that context, it is interesting to note that the September 2016 announcement by DBEIS following the UK Government's decision to press ahead with the Hinkley Point C nuclear project promised that "*The new legal framework for future foreign investment in British critical infrastructure will mean that…There will be reforms to the Government's approach to the ownership and control of critical infrastructure to ensure that the full implications of foreign ownership are scrutinised for the purposes of national security. This will include a review of the public interest regime in the Enterprise Act 2002 and the introduction of a cross-cutting national security requirement for continuing Government approval of the ownership and control of critical infrastructure*."[14]

As discussed above, the existing merger control regime in the UK (at both the domestic and EU level) already allows the Government to intervene in transactions to protect national security. Likewise, the Court has previously recognised that national measures regulating investments in the energy and infrastructure sectors may in principle be compatible with EU rules on free movement of capital and freedom of establishment. Indeed, DBEIS believes that the proposed changes (which, at the time of writing, have not been set out in any detail) will "*bring Britain's policy framework for the ownership and control of critical infrastructure into line with other major economies… while the UK will remain one of the most open economies in the world, the public can be confident that foreign direct investment works in the country's best interests*".

In contrast to the political debates at the time of Kraft/Cadbury and Pfizer/AstraZeneca, however references to EU law limitations on the ability of the UK Government to intervene in cross-border acquisitions or investments in "*critical infrastructure*" projects were conspicuous by their absence in both the Prime Minister's July speech and the DBEIS announcement. While there is a high degree of uncertainty as to what form Brexit will take, if that means an exit from the EEA as well as the EU, this would seem to suggest that acquirers of businesses in strategic sectors meeting both UK and EU merger control thresholds should be prepared for the possibility of three parallel reviews: on competition grounds under the EUMR and EA02 in Brussels and London respectively and potentially also on the basis of an expanded UK public interest test. That said, in recent years there has been a proliferation of initiatives – both 'hard' and 'soft' – to minimise the potential for divergence between different merger control authorities' reviews of the same underlying transaction, ranging from participation and discussion within networks of competition authorities (most notably the International Competition Network) to bilateral cooperation between jurisdictions on a case-by-case basis. Regardless of the terms of Brexit, it would seem likely that the UK will seek to maintain a similar policy for the vast majority of cross-border M&A transactions.

[13] While this provision has never been tested, it would seem likely that were the UK to seek to rely on it while still part of the EU, the Commission and (potentially) the Court would view this as an infringement of the EU laws on free movement of capital and freedom of establishment described above.

[14] See footnote 2 above. In the same announcement DBEIS also stated that: (i) the UK Government will take a special share in all future nuclear new build projects in order to ensure that significant stakes cannot be sold without the Government's knowledge or consent; and (ii) the UK's nuclear regulator, the Office for Nuclear Regulation (ONR), will be directed to require notice from developers or operators of nuclear sites of any change of ownership or part-ownership so as to allow the Government to advise or direct the ONR to take action to protect national security as a result of a change in ownership.

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