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COVID-19 AND UK MERGER CONTROL: ACQUIRING DISTRESSED BUSINESSES

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Despite unprecedented efforts to support industry, the COVID-19 outbreak will continue to challenge businesses, and it appears inevitable that a growing number will fail as a result.

Although many companies have put their "pre-crisis" acquisition plans on hold, the fallout from the current outbreak is likely to present certain companies with opportunities to acquire distressed firms, or the assets of such firms.

Against this background, the following update considers why, when planning to acquire a distressed firm (or its assets) with links to the UK, the following are essential requirements:

- the acquiring party should determine at an early stage if, and how, the UK merger control regime would apply to that acquisition, and its risk profile in this context;
- where the UK merger control regime is applicable, the acquiring party should determine its strategy in relation to engaging with the UK Competition Authority (CMA) in respect of the acquisition; and
- the acquiring party should not assume that the CMA either would not investigate the acquisition, or would investigate but would proceed to clear the acquisition, simply because the target is in financial distress.

The CMA's ability to investigate completed acquisitions with links to the UK

Under the UK merger control regime, there is no requirement to obtain clearance from the CMA before completing an acquisition.

Where an acquisition is completed without merger clearance, the CMA is able to open a merger investigation for a period of up to four months from the material facts of the acquisition either (i) being made public;[1] or (ii) otherwise being brought to the CMA's attention.

Asset acquisitions

Importantly, even if a firm has ceased trading, the acquisition of its share capital, or all or part of its assets, may still be capable of investigation under the UK merger control regime.

For example, the UK's Supreme Court has previously confirmed that, on the facts of the case, the completed acquisition of certain assets of a liquidated entity (including vessels, staff, brand, customer lists, and property) was an acquisition that was capable of being investigated under the UK merger control regime.[2]

Risks of completing without clearance

As outlined previously, where a completed transaction is investigated by the CMA, this presents a range of risks for the acquiring party, including:

- the possibility of an initial enforcement order (IEO) being imposed by the CMA, requiring that the acquired business is "held separate" from the acquiring party;
- the CMA requiring the appointment (at the parties' cost) of a monitoring trustee, and/or a so-called "hold separate manager" to ensure compliance with, and the appropriate implementation of, the IEO; and
- ultimately, the acquiring party being ordered to divest all or part of the acquired business.

Initial considerations where the target has links to the UK

With this in mind, if a target firm or its assets has links to the UK (including, for example, turnover, activities, employees, and/or IP rights[3]), the acquiring party should confirm at an early stage:

- whether the UK merger control regime would apply to the acquisition of the target (i.e. having regard to each of the "value of UK turnover" test, and the "share of supply" test);[4] and
- if so, whether the acquisition would be likely to give rise to competition concerns under the UK merger control regime, and whether any such concerns could be effectively addressed (e.g. by offering targeted divestments to remedy specific concerns) without compromising the rationale for the acquisition.

The CMA will not clear acquisitions simply because the target is in financial distress

The fact that a target business is in financial distress does not in and of itself provide a route to clearance under the UK merger control regime.

In a Phase 1 merger investigation, in the absence of evidence to the contrary, the CMA will generally assess the effects of a completed acquisition against the conditions of competition that existed pre-acquisition.[5]

If an acquiring party argues that the target would have exited the market in any event, such that the acquisition does not give rise to competition concerns, the CMA would need to be confident that the following three "failing firm" conditions were satisfied:

- that the target would inevitably exit the market (with the CMA having regard to the financial position of the target business, and its wider corporate group where relevant);
- that there is no alternative acquirer that would result in a substantially less anti-competitive outcome (with the CMA generally taking into account the prospects of alternative offers above the liquidation value of the target); and
- that the acquisition does not represent a substantially less competitive outcome compared to what would have happened to the sales of the target upon its exit - for example, if the acquiring party would have secured the majority of the target's sales upon its exit, the acquisition may be expected to have a limited effect upon competition.[6]

If any of these three conditions are **not** satisfied, the CMA will generally revert in a Phase 1 investigation to assessing the effects of a completed acquisition against the pre-acquisition conditions of competition.

Depending upon the positions of the acquiring party and the target, this assessment may identify competition concerns arising from the acquisition, particularly if the acquiring party has already sought to convince the CMA that it is a close competitor of the target (e.g. on the basis it would secure the majority of the target's sales upon exit).

Factoring in the UK merger control regime at a time of crisis

The "pre-crisis" decisional practice of the CMA confirms a restrictive application of the "failing firm" conditions, with parties' arguments and evidence cautiously examined and tested, and with third parties' views sought by the CMA (e.g. the views of possible alternative acquirers).

While the CMA is likely to face pressure to loosen its application of these conditions in response to the current crisis, it is notable that the CMA's predecessor, the Office of Fair Trading, continued to apply these conditions robustly during the financial crisis of 2008.[7]

Further, although the economic impact of the current crisis is anticipated to be greater than the financial crisis of 2008, it would be very surprising if the CMA opted to clear acquisitions which it believed gave rise to competition concerns on the basis of a looser application of the "failing firm" conditions.

With this in mind, if the UK merger control would apply to the acquisition of a distressed firm (or its assets), it would be advisable for the acquiring party to determine at an early stage its strategy in relation to engaging with the CMA in respect of the acquisition.

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[1] The CMA will normally consider an acquiring party to have publicised material facts by 'publishing and prominently displaying on its own website a press release about the transaction' (see, ME/6830/19, Completed acquisition by Bottomline Technologies (DE), Inc. of certain assets of Experian Limited, paragraph 39; and 'Mergers: Guidance on the CMA's jurisdiction and procedure (CMA2)', January 2014, paragraph 4.44.
[2] See, Société Coopérative de Production SeaFrance SA v The Competition and Markets Authority & Another [2015] UKSC 75.
[3] See, ME/6831/19, Anticipated acquisition by Roche Holdings, Inc. of Spark Therapeutics, Inc.
[4] See, Enterprise Act 2002, section 23.
[5] See, 'Mergers: Guidance on the CMA's jurisdiction and procedure (CMA2)', January 2014, paragraph 4.3.5. For completeness, the CMA will generally assess the effects of an anticipated acquisition against the prevailing conditions of competition.

[6] See, ME/6870/19, Completed acquisition by Danspin A/S of certain assets and goodwill of LY Realisations Limited (formerly Lawton Yarns Limited), paragraph 33; and 'Merger assessment guidelines (CC2/OFT1254)', September 2010, paragraph 4.3.8 onwards.
[7] See, for example, the paper 'Competition policy in troubled times' by John Fingleton, CEO of the Office of Fair Trading, 20 January 2009, which provides that "[a] recession can facilitate strong growth in long term productivity. Unlike a boom, when inefficient players may survive and even grow, an economic downturn will tend to drive out the less efficient market players. This process of creative destruction leaves a stronger and more efficient supply base, thus driving innovation and productivity growth in the next period of expansion. This is a reason why competition agencies should apply a rigorous failing-firm 'defence', especially in a downturn".

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