



M&A STANDPOINT RAISING THE DRAWBRIDGE OR LEVELLING THE PLAYING FIELD?

PROTECTIONISM IN UK M&A AND THE CONSERVATIVE MANIFESTO

The UK Conservative Party published its Manifesto yesterday entitled "Our Plan for a Stronger Britain and a Prosperous Future". It sets out the policies that would be adopted should the Conservative Party win the general election on 8 June. Notwithstanding the unpredictable nature of referenda and elections around the globe over the last year, the broadly held view is that the Conservatives will win another term (the best odds currently offered by bookmakers on a Conservative majority are 14/1 on). Therefore what the Manifesto says about the prospective government's approach to industrial policy and M&A merits scrutiny. Before looking at what the Manifesto says in these areas, and about takeovers and mergers in particular, it may help to put it in context.

CURRENT MERGER CONTROL PROCEDURES FOR M&A TRANSACTIONS

The UK's current merger control regime has largely prevented successive governments from pursuing a protectionist policy in respect of mergers and acquisitions and its broader industrial policy should they have been so inclined. Protectionism has further been restrained by EU legislation including the EU Merger Regulation ("EUMR") and the anti-state aid rules which prevent member states from preferring domestic businesses over foreign entities. This could be said to have provided a shield to governments, not actually inclined to pursue a protectionist policy, from being accused of not prioritising the national interest. However, since the global economic downturn there has been a rising domestic trend to criticise foreign investment in UK companies. With the EU referendum offering the new government a chance to recast merger control rules in the UK, and a call for a more robust industrial policy aimed at reining in the perceived shortcomings of the free movement of capital, the implications for cross border mergers and acquisitions in the UK are potentially significant.

The current UK legal landscape for merger control is subject to the EUMR, which aims to provide a "one-stop shop" for transactions within its scope and gives the European Commission power to regulate and prohibit large cross-border deals. There are some limited exemptions from the EUMR regime, which allow member states to protect their legitimate interests with respect to public security, the plurality of the media and prudential regulation of the financial sector. The Commission may also permit further exemptions if requested by the member states.

If a UK deal does not fall within the EUMR, it may be governed by the domestic UK regime contained in the Enterprise Act. Like the EUMR this contains a largely competition based substantive merger control test, removing the previous political discretion exercised by the Secretary of State. The Secretary of State can intervene on broadly the same basis as apply under the European regime namely national security, media plurality and financial stability. These aren't expressly focussed on foreign ownership, rather on the protection of certain industries more generally.

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M&A STANDPOINT: RAISING THE DRAWBRIDGE OR LEVELLING THE PLAYING FIELD?



Alongside the domestic merger control regime, several industries are separately regulated and their sectoral regulatory bodies are involved in assessing the potential effects of mergers. These include, amongst others, Ofcom for the ownership of newspapers and broadcasters, Ofwat in water, Ofgem in energy and the FCA and PRA in regulated financial services. While these sectoral regulators are fairly numerous, their ability to become involved in merger control is largely limited to the areas of competence under which the Secretary of State may intervene under the Enterprise Act, and broadly reflect the limited role the government takes in the current merger control regime. Importantly, they do not discriminate against foreign owners.

NEW RULES FOR A CHANGING ECONOMY

In the section headed "New Rules for A Changing Economy", the Manifesto sets out policies on employees' rights, corporate governance, tax avoidance and the regulation of takeovers and mergers. All of these have implications for M&A; the focus of this Standpoint is the last of these.

While stating that it wants the UK to welcome overseas investment, the Manifesto caveats that by saying it does not want inward

investment driven by aggressive asset stripping or tax avoidance. This signals that the Conservative party may wish these to be relevant areas in any new disclosure requirements imposed on bidders and relevant considerations in any new governmental powers to review transactions (as described below). This prompts the question of whether a government would be able to introduce such requirements while the UK remains in the EU. As noted above, the EU can allow member states who request permission to extend their domestic jurisdiction over transactions if it is to protect a member state's 'legitimate interests' in specific areas. However this has been interpreted narrowly and any exemption must still be compatible with the general principles and provisions of EU law, notably the free movement of capital and freedom of establishment.

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REFORM OF RULES ON TAKEOVERS

The Manifesto commits to an update on the rules for takeovers but states that this will require careful deliberation. The method of implementation, and consultation process in advance, will depend on the measures to be adopted. It seems most likely that this will require a combination of legislation through the parliamentary process either to amend existing regimes such as the Enterprise Act or to introduce wholesale new legislation, as well as changes to the Takeover Code, initiated by the Code Committee of the Takeover Panel, in response to any such legislative proposal and addressing how to adapt the Takeover Code processes appropriately.

The Manifesto is specific on a number of proposals in the context of public takeovers:

- An increased level of disclosure at the outset of a deal about the bidders' intentions toward the target company. From the current government's statements on industrial policy over the last year, the focus here is likely to be on jobs and investment, in particular in R&D, and reflects the concerns raised variously in the Kraft/Cadbury, AstraZeneca/Pfizer and Softbank/ARM bids. It remains to be seen whether this is merely a change in the timing of such disclosure (which is already required, but only in the offer document as opposed to at the bid's announcement) or a change to the extent of such disclosure.
- Ensuring promises and undertakings made during a bid can be legally enforced. There is already a mechanism in the Takeover Code to achieve this for certain statements which are given as commitments (see [our Standpoint article on these requirements](#)), so this signals that the Conservatives may want the existing regime broadened in scope in terms of the statements potentially covered, and the enforcement regime strengthened.
- The ability for the government to freeze a bid process to allow greater scrutiny (presumably by the Government). This appears to be in addition to any existing competition, public interest or industry specific review regime and is separate

from the review regimes to be applicable to specific, or to be specified, industries, described below. It raises questions about the nature of the proposed scrutiny, the basis on which transactions might be assessed and by which authorities, and the consequences of falling short of whatever test might be set. It is hard to tell from the Manifesto whether this is a new power of scrutiny or simply a power to pause bids while existing (and new CNI) powers of scrutiny are exercised. One issue will be whether this could potentially interfere with the "Put Up or Shut Up" (PUSU) regime, giving a bidder 28 days to commit to a bid or walk away, which was put in place post the Kraft/Cadbury bid to stop a target from being put under siege.

CRITICAL NATIONAL INFRASTRUCTURE

As well as these measures which would apply to public bids across all industries, the Manifesto states that the Conservatives will protect critical national infrastructure ("CNI") from being undermined by foreign ownership. This reflects the current Government's Industrial Policy, as set out in its Industrial Strategy Green Paper in January 2017. A statement on the protection of CNI has been imminent for some time but was delayed by the calling of the election.

On CNI, the Manifesto states that the government, having strengthened the review process around the ownership of civil nuclear power, would extend the review regime to a limited range of other sectors, including defence, telecoms and energy. The Manifesto leaves scope for broadening this list to other areas where foreign ownership might undermine British security or essential services. Pending some more clarity on these new processes and their scope, in particular what constitute "essential services", there will be uncertainty as to which transactions will be subject to them in the future.

The scope of this new regime will be of great interest to potential investors into the UK. As well as having clarity on how relevant sectors are defined, investors will want to understand what the other relevant criteria will be; for example, at what level "control" exists – our

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understanding prior to the election announcement was that the government intended to apply the regime at a 25% ownership threshold; will a standard test of "foreign control" apply across the sectors; will there be a threshold transaction size below which no approval will be required; and, most importantly, what criteria will be applied to the Government's determination of appropriate foreign ownership and the degree, if any, of political discretion and transparency.

PENSION PROTECTION AND EMPLOYEE RIGHTS

There are also a number of statements about pension protection and employee rights in the Manifesto which could impact on M&A transactions.

In relation to pensions, there is a commitment to a strengthening of the existing powers of the Pensions Regulator (therefore covering final salary schemes) to scrutinise, clear with conditions or block takeovers that could threaten the solvency of the scheme. A key question will be whether there could be a move to an advance clearance system, in

contrast to the current ability to seek clearance after an M&A deal has completed.

The section on corporate governance suggests that employees will be given "a right to request information relating to the future direction of the company". No further detail is given, but it could potentially apply in the context of M&A transactions. The UK Takeover Code already provides certain information rights for employees on public takeovers, including a requirement for a bidder to state its intentions as regards employees. Any new information rights would need to take confidentiality and inside information concerns into account.

IMPLEMENTATION TIMELINE

These regimes will not be in place for some time, and further clarification on the above is unlikely before the election in June. We understand no more detail will be published formally on these policies prior to the election, with government briefings sticking to a script closely following the Manifesto text. Post election, any implementation will require consultation and the parliamentary process, so any new regime is unlikely to apply to deals scheduled to close in the short term. However

that will not make such transactions immune from commentary, and pressure from various sources, emboldened by the themes endorsed in the Manifesto.

As noted, most of the Manifesto content described above has been trailed in Government statements on industrial policy in the last few years and it is inadvisable to extrapolate from 12 lines in a Manifesto a conclusion that there has been a paradigm shift in the Conservative party's attitude to business and investment. The Manifesto of course needs to maintain a careful balance of meeting the concerns that have been voiced in the general population (it is a document principally aimed at voters) and promoting the UK as open for business, in particular with Brexit in prospect. The devil will be in the detail of the proposals, in particular which industries are in scope. It may reflect the limit of what the Government feels is possible in terms of intervention given the constraints it is subject to while within the EU, or it may well reflect the limits of the Government's wish to intervene in the national interest.