M&A insights

Merger control in Europe: the remedies process

In recent years the trend towards consolidation within sectors has caused the European Commission and other authorities to scrutinise proposed mergers more rigorously, leading to more complex and protracted remedy discussions. At the same time, the authorities are increasingly focused on avoiding a failed remedy and therefore pay closer attention to the identity of remedy purchasers. In response, merging parties more frequently try to allay competition concerns at an earlier stage – 2016 was a record year for merger clearances by the Commission that were subject to 'fix-it-first' divestiture remedies.

At a glance: the divestiture process

There are three main ways to deliver a remedy during M&A.

1. Classic

The classic scenario is a sale of the divestment business within a fixed time limit after the Commission's clearance for the main transaction. The parties may close their transaction after having obtained the clearance, but are required to find a purchaser for the divestment within a short period of time. When the parties have reached an agreement with a purchaser, the Commission is required to approve the purchaser's suitability to buy. This method allows the merging parties to complete the principal deal as soon as clearance is received, and the divestiture of the remedy package follows after closing.

2. Upfront buyer

Where the Commission does not have certainty that the merging parties will manage to divest within a short period of time to a suitable buyer, it may require that the parties propose an upfront buyer. The parties are barred from completing the main transaction after clearance, until they have entered into a binding divestiture agreement with the remedy purchaser and the Commission has approved the purchaser.[1]

3. Fix-it-first

Merging parties may seek to enter into a binding divestiture agreement with a remedy purchaser before the Commission has completed its review of (and, in contrast to the upfront buyer procedure, before the Commission has cleared) the main transaction. In this scenario, the Commission will take the agreement with that buyer into account in its clearance decision for the main transaction and no further buyer approval will be required post-clearance. The merging parties can then complete their main transaction once clearance has been received from the Commission.

The choice between upfront buyer or fix-it-first is typically driven by timing considerations. Whether the Commission's merger control timetable provides sufficient time for the remedy transaction (and identity of the remedy purchaser) to be reviewed and approved prior to clearance of the main transaction (taking into account the expected timeframe to negotiate and agree the divestment transaction with a remedy purchaser) will inform the ability to successfully implement a fix-it-first strategy. Moreover, the Commission will only agree to a fix-it-first remedy and grant simultaneous approval for the main transaction and the remedy when there is certainty that the remedy transaction will complete. In practice, this means that the Commission will revert to an upfront buyer when the remedy transaction is subject to any meaningful conditions precedent that may delay completion (eg merger control or foreign investment clearances).

Classic procedure

Upfront buyer procedure

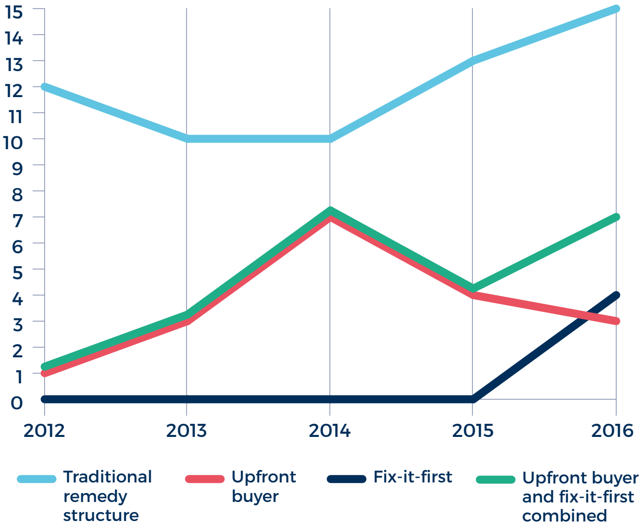
Fix-it-first procedure

[1] In both the classic and upfront buyer procedures, the merging parties are required to enter into an agreement with a divestment purchaser within a deadline specified in the commitments (usually six months).

Rising trend of upfront and fix-it-first remedies

Although the Commission continues to clear most deals that need remedies via the classic procedure, the number of upfront buyer and fix-it-first remedies has risen in recent years (see graphic below[2]). This is driven by industry consolidation and the Commission's desire to avoid failed remedies, by putting the remedy implementation risk on the merging parties and incentivising them to avoid hitches in the divestment process.

European Commission remedy structures, 2012–2016



When would you use a fix-it-first or upfront buyer structure?

The Commission typically insists on an upfront buyer commitment where it thinks the merging parties might have difficulty finding a suitable purchaser for the divestment business, or where there are risks around preserving the competitiveness or saleability of the divestment business between clearance and completion of the divestiture. The Commission may also impose an upfront buyer requirement when the merging parties have found a remedy purchaser before clearance, but completion of the remedy transaction is subject to significant conditionality (eg lengthy merger or foreign investment approvals). In these situations, the upfront buyer model gives the Commission comfort that the main transaction is not completed until there is certainty that the commitments will be implemented.

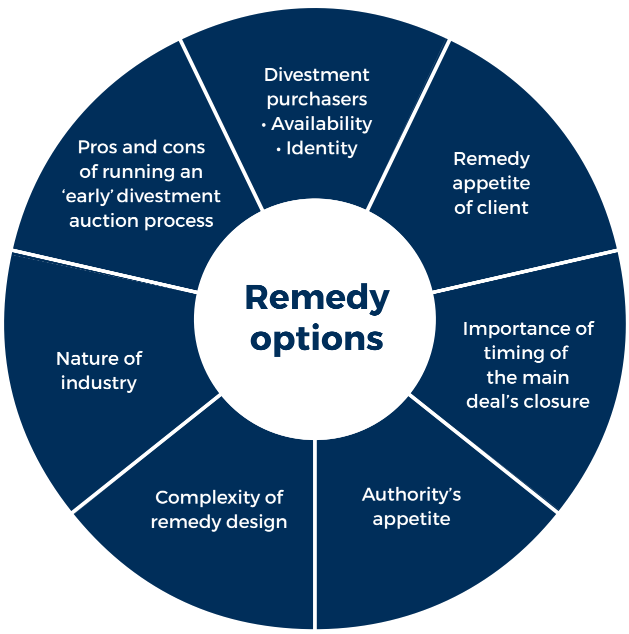
The risks of an upfront buyer solution need to be factored into deal timetables because the merging parties won't be able to complete the main transaction until the divestment transaction agreements have been agreed and approved. To minimise the risk of delay and keep to the overall deal timetable (long-stop date), merging parties may choose to pursue a fix-it-first strategy, particularly where:

- it's clear that there are very few suitable purchasers for the proposed remedy; or
- the Commission can only rule on the effectiveness of the proposed remedy once it knows the identity of the purchaser (eg if the viability of the divestment business depends on the buyer's assets or characteristics).

Which strategy fits best?

The choice of remedy strategy will depend on a number of factors.

- **Are the merging parties willing to offer a remedy, and at what point in the review process?** In a deal that's likely to raise competition concerns, a strategic decision has to be taken as to whether (a) there's merit in fighting the case on the substance (which may result in a longer review period) or (b) it's in the parties' interest to offer remedies early to expedite the review (although this may result in bigger concessions).
- **How important is timing of closing of the main transaction relative to the willingness to offer a remedy?** If a business needs to complete an acquisition by a particular date (eg for financial reasons), it may be best to pursue a fix-it-first remedy.
- **To what extent is the reviewing competition authority willing to engage early?** Competition authorities may be reluctant to engage in meaningful remedy discussions until competition concerns have crystallised.
- **The complexity of the remedy required.** Where merging parties can only (or want to) offer a complex remedy, eg involving a carve-out, technology transfers, transitional supplies or services from the merging parties and customer consent requirements, the risk of an upfront buyer requirement is high.
- **The nature of the industry.** Some industries may have characteristics (complexity, limited number of players) that make an upfront buyer requirement more likely.
- **A weighing of the pros and cons of running an early divestment auction process.** There may be process reasons why it is not feasible to run an early auction process for the assets of the target (which has not yet been acquired) in parallel with the main transaction.



[2] Graphic reflects cases approved subject to a structural, ie divestment, remedy only; behavioural remedy cases have not been included in the statistics. Freshfields acted on all four fix-it-first cases in 2016 (*Liberty Global/BASE Belgium*; *Hutchinson/VimpelCom JV*; *AB InBev/SABMiller* and *Boehringer Ingelheim/Sanofi Animal Health Business*).

M&A considerations

Upfront buyer or fix-it-first structures are more complex to execute than classic procedures.

General M&A considerations

Where proactive remedies are proposed, planning is vital given that the divestment deal will run in parallel with the main transaction. In particular, the parties will need to:

- **identify appropriate internal resource to assist with and manage the divestment process** alongside the main transaction; and
- **agree ways to exchange information between the target, the bidder and potential divestment purchasers in an antitrust-compliant manner.**[3] It's important to carefully manage the requirement in the Takeover Code that targets must provide information given to one bidder to a competing bidder when asked.

Fix-it-first or upfront buyer divestments also introduce constraints that wouldn't usually be encountered on standalone private M&A deals. These may affect the transaction structure and terms that the bidder can, or may be willing to, negotiate with a divestment purchaser.

- **A purchaser will not be in a position to sell the target's assets until it has acquired the target.** The consummation of any agreement to dispose of the target's assets will therefore need to be conditional on completion of the acquisition.
- As an upfront buyer or fix-it-first divestment forms part of a remedy package required for clearance of the main transaction, **certainty of deliverability of the remedy (and, in a public M&A deal, not introducing further conditionality to closing of the main transaction) is paramount.** This is likely to dictate a bidder's approach, eg they may insist on a 'hell or high water' undertaking from the divestment purchaser in respect of the merger control clearances required for the divestment transaction.
- **Certain terms agreed between the parties to a merger will need to be reflected as part of the terms of the divestment.** For example, parties to a complicated merger may have agreed a lengthy long-stop period in order to allow enough time to get the relevant merger clearances. A divestment purchaser may understandably struggle to accept the divestment transaction remaining 'open' for an equivalent long-stop period.

UK public M&A specific considerations

In UK public M&A, the Takeover Code imposes constraints on how the main transaction is structured as well as on proactive remedy processes. But if the offer is pre-conditional, the parties (with the consent of the Takeover Panel) are able to deal with antitrust concerns outside of the Takeover Code's timetable restrictions and before the offer is put to the target's shareholders.

As for the constraints imposed on the terms of fix-it-first or upfront buyer remedy transactions under the Takeover Code, the target will be bound by the prohibition on entering into offer-related arrangements with the bidder or its concert parties during the offer period. This restriction, which stops obligations or undertakings being imposed on the target, will have a knock-on effect on the bidder's ability to provide a divestment purchaser with contractual protections of the type usually expected by purchasers in private M&A transactions, eg pre-closing conduct of business undertakings and business warranties.

In addition, the public disclosure obligations around offer-related arrangements under the Takeover Code may dictate which parties enter into the divestment agreement. The merging parties may structure the divestment agreement to be entered into between the bidder and the divestment purchaser (and not by the target, which owns the business being sold), to try to keep the divestment terms private.

Conclusion

- In transactions that may raise competition concerns, remedies should be considered from the outset and should be integral to the negotiating strategy for the main transaction.
- There are different forms of remedies and not all cases can be settled with a classic post-closing divestment. Competition authorities are increasingly putting the remedy implementation risk on the merging parties by requiring an upfront solution.
- As a result, predicting and managing merger timetables has become more challenging and must be factored into deal documents. Overambitious long-stop dates should be avoided, and each party's respective obligations to ensure regulatory conditions are satisfied should be as clear as possible.
- The most complex deals involve a clear allocation of antitrust risk reinforced by tight contractual obligations. A sophisticated understanding of these risks is crucial to protect each party's interests.

[3] Please refer to the previous issue of M&A insights on clean teams for further information on the practical considerations involved in setting up and administering such arrangements.

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