MAY 2009, RELEASE ONE

GCP
THE ONLINE MAGAZINE FOR GLOBAL COMPETITION POLICY

Merger Action Group v Secretary of State for BERR: External Control of the Scottish Economy, Merger Control and the Scottish 'Ring-fence': the LloydsTSB/HBOS Merger

Barry J. Rodger
Law School, University of Strathclyde

WWW.GLOBALCOMPETITIONPOLICY.ORG

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

Merger Action Group v Secretary of State for BERR: External Control of the Scottish Economy, Merger Control and the Scottish 'Ring-fence': the LloydsTSB/HBOS Merger

Barry J. Rodger[1]

I. INTRODUCTION

The recent merger between Lloyds/TSB and HBOS has again raised concerns regarding the increase in external control of Scottish companies and also demonstrates many facets of the merger control system in the United Kingdom which was revised by the Enterprise Act 2002. The legal context for consideration of the merger is the challenge to the merger approval process by a number of interested third parties based in Scotland, grouped together as the Merger Action Group, ("MAG") before the Competition Appeal Tribunal ("CAT"). However, this brief article will focus more on the economic and legal context in which the challenge arose rather than the outcome of the review proceedings, providing a particularly personal view of the merger and its potential impact on the Scottish economy.

The merger between these parties involved one of the most important Scottish commercial institutions, the Bank of Scotland, which years earlier had combined with the Halifax Building society, but had retained its head office in Edinburgh and effectively its independent status. The Bank of Scotland was created by an Act of the Scottish Parliament in 1695 and its name and brand have had an important historical and cultural importance in Scotland. HBOS collectively is a financial services group providing a range of banking and financial services with a U.K. turnover of £4.25 billion in 2007. It was estimated at the time of the merger that HBOS had approximately 320 branches and 17000 Scots employees and LloydsTSB had 185 branches and 7200 Scots employees. Accordingly, there were considerable concerns at the direct and indirect impact the merger would have on the Scottish economy, an issue which had been of particular historical interest under the U.K. merger controls, and which resurfaced during this merger saga.

II. THE ECONOMIC EFFECTS OF INWARD ACQUISITION INTO SCOTLAND

A key problem is that inward investment into Scotland is most commonly achieved by acquisition of existing companies. The merger boom of the 1980's exacerbated this trend towards external control in the Scottish economy and this has been witnessed again in recent years. A Scottish Council Report in 1969 considered the

[1] **Barry J Rodger is Professor, Law School, University of Strathclyde, Glasgow. He can be reached at barry.j.rodger@strath.ac.uk.**

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

probable detrimental effects ensuing from the centralizing process in the United Kingdom. It was argued that the centralization of headquarters and, hence, decision-making in London could have serious implications for the long-term growth of the Scottish economy. The most talented young people would inevitably leave Scotland in an attempt to enhance their career prospects.

Also, voluntary involvement in public life in local, social, and political organization by such people, on which a successful democracy largely depends, may be hampered by the loss of top decision-makers from Scotland. External control may also have knock-on or related effects detrimental to the long term vibrancy of the area, by resulting in a reduction of demand for professional services within the local economy, and the consequent loss of employment and income generation within those sectors. The economic study by Ashcroft and Love in 1993 also stressed that U.K. merger policy should consider the regional implications for Scottish takeovers in particular.

III. UK MERGER CONTROL—THE FAIR TRADING ACT 1973

Indeed, under the Fair Trading Act 1973, the legislation which preceded the current merger control system in the Enterprise Act 2002, this was feasible. Under the 1973 Act, the Monopolies and Mergers Commission ("MMC", which has now been superseded by the Competition Commission), was required to assess mergers referred to it according to the public interest and, in particular, had to take into account the desirability of maintaining and promoting the balanced distribution of industry and employment in the United Kingdom. This was known as the regional policy guideline. In relation to takeovers of Scottish companies in particular, the MMC was at one stage criticized for almost creating a "ring-fence" around Scottish companies in its interpretation of this guideline.

This is certainly no longer the case, but there was an era in which considerable weight was given to the regional policy issue. There were a series of MMC reports in the late 1970s and early 1980s culminating in the MMC's Report into two takeover bids for The Royal Bank of Scotland in 1982. The MMC accepted that loss of Scottish control of the Royal Bank of Scotland would be seen as a significant step in the long process of centralization and of weakening local control over economic affairs. It would reinforce the impression of a "branch economy" and diminish confidence and morale in Scottish business.

Similarly, during the takeover bid by Carter Consolidated for Anderson Strathclyde the MMC recommended blocking the merger. This majority conclusion was rejected by the Minister who allowed the merger to proceed. The dominance of regional policy considerations in Scottish takeovers by the MMC also apparently diminished with this report. The alleged "ring-fence" was in fact erected barely a handful of times

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

and then only to protect those companies virtually essential for the viability of the Scottish economy. In the late 1980s/ early 1990s, the "Guinness Affair," the British Petroleum (BP) takeover of Britoil, and Tesco's takeover of William Low's wherein significant components of the Scottish economy were transferred out of Scottish hands, highlighted that the issue had moved onto another plane. In order for the MMC to investigate a merger it required to be referred by the Secretary of State.

The dominant influence on merger policy in this period was the "Tebbit Doctrine." Merger policy was made at least as much at the referral stage as by the MMC. The effect of the Tebbitt doctrine was that the regional effects of mergers occupied a low level of priority among the reasons for referral, making it unlikely that the MMC would be able to consider the particular effects of the loss of control of indigenous Scottish companies.

This was dramatically demonstrated in the takeover of Distillers by Guinness in the mid 1980's, a second bid being cleared by the authorities without referral to the MMC. The main criticism, and probably the subject of greatest public outcry, particularly in Scotland, arose when Guinness reneged, and was allowed to do so, on various commitments designed to appease Scottish concerns. The merger was "Good news for Scotland" based on the promise that corporate headquarters of a new Scottish-registered holding company, with its Board, would be established in Edinburgh. This and other promises were subsequently broken, justified by Guinness on the basis that commercial logic had dictated that executive control must remain in London. Subsequently, similar commitments were reneged upon by BP after its takeover of Britoil, and the Scottish economy had to rely on the goodwill of an outside company to implement commitments which made little logistical sense to that company.

Since 1985 Scottish manufacturing capital has been drastically reduced as companies like Bells, House of Fraser, Anderson Strathclyde, Distillers, Britoil, William Low, and others have been successively taken over by "outside" predators. The importance of ensuring that commercial decisions affecting Scottish companies and Scottish industry are taken in Scotland must not be underestimated. The long-term growth of the Scottish economy depends to a large extent on having top level management, financial services, and headquarters functions here. The retention of these functions is vital if enterprise and innovation is to continue to increase in Scotland, and the existence of an independent banking sector requiring considerable input from other service industries in Scotland is an important aspect of this broader debate.

IV. MERGER CONTROL UNDER THE ENTERPRISE ACT 2002

The reform process in relation to the transformation of U.K. competition policy in the late 1990s and early part of this decade, culminating in the Competition Act 1998 and

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

the Enterprise Act 2002, was not particularly radical in relation to U.K. merger policy. The "depolitization" of U.K. merger control achieved by the Enterprise Act 2002 sought to ensure the removal of politicians from the merger control process which would be undertaken by the independent competition authorities, the OFT and the Competition Commission. However, although the Enterprise Act makes specific provision in relation to the SLC competition test and, in particular, for consideration of the consumer interest by the competition authorities; effectively, the broad process and focus on competition issues ensures that in most cases the process and outcome would be identical under the 1973 Act and new 2002 Act provisions. Of course, the legal framework is not quite as simplistic as this outline presentation. There are detailed provisions for intervention by the Secretary of State in relation to certain public interest cases, where a merger falls within a public interest consideration designated under section 58 of the Enterprise Act.

V. THE LLOYDSTSB/HBOS MERGER

On September 18, 2008 LloydsTSB and HBOS announced that they had agreed the terms of a merger, subject to no reference being made to the Competition Commission for a full merger investigation under the Enterprise Act 2002. The merger discussions took place against the background of the unprecedented crisis in the financial markets and the particularly precarious position facing HBOS which had been particularly exposed to the risk of sub-prime related mortgage securities. The proposed merger was clearly welcomed by the U.K. Government as a means of saving a financial situation without direct support of the type which had been necessary earlier to rescue Northern Rock.

Nonetheless, it should be noted that the Government's haste to support the proposed merger came in the midst of the Government's introduction of a series of financial measures, under a Community framework to relax the state aid rules, to invest in and support and stabilize the U.K. banking system, effectively taking swathes of the banking sector into public ownership. However, in a drastic effort to avoid a reference to the Competition Commission by the OFT, the Secretary of State, Lord Mandelson, piloted a rushed amendment to the Enterprise Act 2002 through Parliament to add a new public interest consideration in section 58(2)(D), namely the interest of maintaining the stability of the U.K. financial system. An intervention Notice was issued, requiring the OFT to investigate and report on the proposed merger, in particular whether the test for reference to the Competition Commission on competition grounds had been met. This was made under section 42 which provides for the case, as here, where a special public interest consideration is contemplated but not yet adopted. In fact, the OFT was required to finalize its report by the 24th of October, the same day on which the Order introducing the new financial stability public consideration was passed by the House of Lords and entered into force.

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

Under the complexities of the statutory scheme for special 'public interest' mergers, the OFT was not required to consider the public interest consideration. The OFT found that the test for a reference to the Commission had been satisfied in relation to three areas of overlap between the merging businesses in that there was a realistic prospect of a substantial lessening of competition in relation to personal current accounts ("PCAs"), banking services to small and medium-sized enterprises ("SMEs"), and mortgages. The impact on SMEs was particularly focused at the Scottish level.

However, the Secretary of State took into account submissions by other parties, notably the Financial Services Authority and Bank of England, and decided that the new public interest consideration specified in section 58(2)(D) was relevant and moreover that taking that and the predicted SLC into account, the merger was not expected to operate against the public interest. Accordingly, in the face of the OFT recommendations, as provided for by the exceptional public interest provisions in the legislation, the Secretary of State refused to refer the merger to the Competition Commission, effectively clearing the merger. It was this decision which was the subject of the review proceedings before the CAT.

VI. MERGER ACTION GROUP V SECRETARY OF STATE FOR BERR

The Competition Appeal Tribunal is rapidly developing a wide-case-load as a tribunal of specialism under U.K. competition law with multi-competences, notably to hear appeals from decisions of the OFT and regulators under the Competition Act and to deal with follow-on damages actions. Its workload in these areas is increasing, and there have been a considerable number of cases in recent years in relation to its third primary task, introduced by the Enterprise Act 2002, of reviewing the decisions and processes of all the bodes involved in the market and merger investigation systems under the Enterprise Act 2002.

Given the context of the dispute, it is also worth noting that the CAT decided as a preliminary matter that the CAT would be sitting as a Scottish tribunal under the CAT's rules, although in fact the proceedings took place at the CAT in London. This may, nonetheless, have influenced its consideration, in the exceptional circumstances of the case, that the applicants—who were all resident in Scotland, and some of whom (or their business or families) had bank accounts in Scotland or received banking services in Scotland, and all had a "generalised consumer interest in UK banking"—constituted "aggrieved persons" who could bring a review application. The CAT noted that the situation was borderline but took account of the "specific interest and strong feeling which the merger aroused in Scotland" (para. 47).

This finding may be important in future given the potentially wide impact a potential merger may have and clearly extends the scope of the review provision beyond

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.

immediate competitors and those in related markets. Of course, ultimately the outcome of the CAT case was disappointing for the applicants, whose application was dismissed, essentially on the basis that the Secretary of State had not fettered his discretion in taking the decision nor had he failed to treat the OFT's findings on the competition issue as binding (and moreover, rejecting the contention that insufficient attention was paid to alternative means of addressing HBOS's problems). I will leave any comment or discussion of this aspect to public lawyers more familiar with the complexities of the law relating to judicial review.

VII. CONCLUSIONS

The Enterprise Act 2002 effectively depoliticized U.K. merger control and sought to remove the public interest focus of the merger control process, which had allowed regional policy to become an important aspect of U.K. competition policy, at least until the late 1980s. In any event, external control of the Scottish economy had been increasing and U.K. merger policy since the late 80s has failed to address the concerns raised by economic studies into the effects on the Scottish economy of mergers which exacerbated this phenomenon.

Of course, given the complicated legal framework introduced by the Enterprise Act and the passing of the Order in relation to the financial stability consideration, this episode involving Lloyds TSB/HBOS cannot be described as some form of temporary moratorium on the application of the U.K. competition laws. There is concern that the exceptional public interest provisions, confined initially to national security interests, may be extended to cover any particular political "hot potato." Nonetheless, the greatest irony of the merger control outcome in this case is that if the Lloyds TSB/HBOS merger had arisen thirty years ago, the public interest test would have ensured the merger would have been referred to the Commission (then MMC), but in the post-public interest depoliticized merger control context, this particular merger was actually cleared under the specific public interest consideration related to the financial stability of the United Kingdom.

Competition Policy International, Inc. © 2009. Copying, reprinting, or distributing this article is forbidden by anyone other than the publisher or author.