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I. INTRODUCTION

This article discusses the application and practical implications of merger control rules to certain transactions not traditionally seen as mergers; namely, the taking for a certain period of time of an equity stake by a bank in a company that faces financial difficulty, in return for a write-down of (some of) the outstanding debt. This “debt-for-equity swap” is usually part of a wider restructuring and refinancing.

The authors suggest that such transactions rarely raise competition law concerns and that the application of merger control rules (and, in particular, obligations under the European regime as well as others to suspend completion until a formal clearance has been obtained) can be an unwanted and unnecessary additional hurdle in what is already a stressful and complex deal. At a time when restructurings are prevalent, we suggest that thought might be given to possible changes to the application of suspensory obligations for debt-for-equity deals.

II. BACKGROUND

Debt-for-equity swaps are not new. They are a long established technique for the restructuring and refinancing of companies that are no longer able to service their loans. They often involve a company’s lender (or lenders) agreeing to support the business throughout the economic cycle, restore it to profitability, and put its future on a steady footing. They are, therefore, important tools in the wider economic recovery and they contribute to the growth agendas of governments and competition authorities worldwide.

Almost all businesses borrow money, mostly from banks. Following the turmoil in the global financial markets and the corresponding cutbacks in investment by public and private institutions, many businesses have struggled. Some reached a point at which they were unable to meet the repayments on the original loan. In addition, the debt burden sometimes adversely affected the running of the business itself (for example, suppliers insisting on up-front payments when credit insurance became unavailable or unaffordable). In many instance the lenders, rather than enforcing their security and appointing an administrative receiver, have taken a more proactive and progressive solution by converting some of that debt into a shareholding. A bank that does so will typically seek further “influence” over the borrower by insisting on additional rights; for example, the right to appoint one or more directors, to veto strategic decisions, or to approve the business plan (in order to protect its loan). In these circumstances merger control rules and filing obligations can be triggered.

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III. THE APPLICATION AND PRACTICAL IMPLICATIONS OF MERGER CONTROL RULES

If merger control rules do apply to a “debt-for-equity” transaction, this can have serious implications for the overall restructuring, particularly if the regime that is triggered is both mandatory and suspensory. The need to file with a regulator and wait for clearance can dramatically cut across every other imperative of a restructuring strategy. In extremis, a client with a non-performing loan simply may not survive unless the restructuring can complete quickly.

These considerations put pressure on external and internal competition law advisers to the lending banks to give practical, sophisticated, solution-oriented advice. Their ability to do so may depend heavily on which merger control regimes are relevant to the transaction.

IV. WHICH MERGER CONTROL REGIMES ARE RELEVANT?

One of the first issues that competition advisers will be called upon to consider is whether any mandatory, suspensory regimes are triggered by the proposed restructuring. In many ways this is no more than a traditional jurisdictional analysis but with three particular twists that can make bright line advice more difficult to give.

First, almost by definition, at least one of the “undertakings concerned” in the restructuring is likely to be a bank. Frequently this is a large financial institution with, in all likelihood, worldwide and Community-wide turnover of several billion euros.² As a consequence, if that bank is taking decisive influence over a “target” (i.e. the borrower) and the target has Community-wide turnover of over EUR 250 million, the restructuring is highly likely to trigger EU merger regulation (“EUMR”) thresholds (unless an exception applies, such as the two-thirds rule).

Second, in many crisis-restructuring scenarios, there is not just one lender but a group or consortium of different lenders. This has a number of consequences. Most obviously, if a second (or third) lender is also taking decisive influence then the transaction will be assessed as an acquisition of joint control. As a result, all equitizing lenders (as well as the target or borrower company) will be undertakings concerned. Because of the way Article 1(2) and 1(3) EUMR are structured, once a joint control structure is decided upon, it is even more likely that the EUMR thresholds will be triggered, irrespective of the turnover of the target itself. Each lender by itself is likely to have substantial turnover on both a Community-wide and worldwide basis. Article 1(2)(b) and 1(3)(d) EUMR require the turnover of “each of at least two” undertakings to be taken into account and the mere fact of joint control is likely to trigger the requirement to file in Brussels and wait for clearance.

Third, competition lawyers are used to advise on whether a proposed transaction structure will give rise to decisive influence, but a debt-for-equity restructuring is particularly likely to throw up issues where a sophisticated qualitative judgment is required. Examples of grey areas pertinent to these scenarios may be:

² For EUMR purposes, the turnover of financial institutions is calculated using the particular provisions in Article 5(3)(a) EUMR. In essence, interest income, income from securities, commissions, net trading profits, and other operating income are all considered to be “turnover.” Some banks also have an insurance arm, to which Article 5(3)(b) will apply.

- a lender or lenders taking a sub-50 percent stake but with particular strategic veto rights (upon which a lender whose client is struggling may be strongly minded to insist);
- the inclusion (for the lender's or lenders' benefit) of reserved matters, directorship appointment rights, and even quoracy requirements; and
- whether a group of equitizing lenders will have a "commonality of interest," or whether their arrangements for the governance of the company can be structured within the "shifting alliances" framework of the Consolidated Jurisdictional Notice such that no lender, either by itself or with others, can exercise decisive influence.³

The art of giving practical, sophisticated competition law advice in difficult crisis circumstances is further complicated by the fact that the equitizing lenders will likely consider themselves simply to be rescuing (rather than "acquiring") a business. Their aim is usually to relinquish control once the rescued company has overcome its financial crisis. The competition lawyer, with his or her questions and concerns about the minutiae of the governance structure and his or her warnings that a mandatory filing may be required, may not be the most popular adviser in the room.

Of course, if timing is absolutely of the essence, such that the requirement to suspend completion pending clearance would be likely to have catastrophic consequences, then there are a number of options on which competition lawyers will be able to advise. For example, it may not be commercially essential for the equitizing lender to take a decisively influencing stake. Equally, it may be possible to persuade the European Commission to allow derogation from the suspensory effect of Article 7(1) EUMR. Each of these options, however, carries a degree of uncertainty, commercial compromise, and (in the case of derogation) a risk that the European Commission might not grant the request.

V. EVEN IF DECISIVE INFLUENCE IS NOT ACQUIRED, MATERIAL INFLUENCE MAY BE RELEVANT

For some debt-for-equity swaps, if the transaction is structured in such a way that no decisive influence is being conferred on the lender or lenders, that may be the end of the jurisdictional assessment. However, it is more likely that the control criteria of other regimes will still need to be considered. Filings can be required by national competition authorities (such as in Germany and Austria) at well below the levels of control that would confer decisive influence. Such regimes will be particularly relevant where the borrower's business has a close nexus with that jurisdiction.

For lenders with a U.K. focus (and whose clients are therefore likely also to be U.K.-based) the issues which the competition lawyer will now need to consider are two-fold. First, is the (non-decisive) position being taken by the equitizing lender nevertheless a "materially" influencing stake? If it is, can completion nevertheless go ahead unconditionally (i.e. without having to notify the OFT and wait for clearance)?

Although the subject of much debate and an ongoing U.K. government consultation,⁴ the United Kingdom operates a voluntary merger control regime. For equitizing lenders in corporate

³ Consolidated Jurisdictional Notice, ¶¶ 76-80.

⁴ Department for Business, Innovation and Skills, A COMPETITION REGIME FOR GROWTH: A CONSULTATION ON OPTIONS FOR REFORM, Ch. 4.

recovery situations, this is a great benefit of real practical and commercial significance; it allows them to self-assess the competitive effects of the restructuring and, if so advised, not to file.

Although the result can be very different if the EUMR thresholds and control levels are triggered, in practice all restructurings will require competition lawyers to consider not only the jurisdictional but also the substantive effects of the transaction on competition.

VI. SUBSTANTIVE ANALYSIS

It is rare (but not unheard of) for a debt-for-equity swap to give rise to substantive competition law concerns. Nevertheless, the work involved in assessing the competition law risk can be substantial, requiring the equitizing lender that is taking material or decisive influence to identify and consider all other positions of influence it holds in the same sector of the target. For many banks getting a sense for the extent of overlaps can be complex and time-consuming (considering that their main business is not the acquisition of control of companies in a specific sector).

In a case of joint control, or in which the “associated persons” doctrine provided for by section 127 of the Enterprise Act 2002 is invoked (if the OFT has jurisdiction), the substantive analysis will involve an assessment of the potential overlapping interests of all equitizing lenders. If material substantive overlaps are identified, then thought needs to be given by all parties on how to deal with them. If there is a real risk that such overlaps could hold up completion of a time-critical restructuring, then appropriate undertakings and remedies may need to be developed rapidly.

Of equal importance, risk will need to be appropriately allocated in the transaction documentation so that the deal can go ahead as speedily as possible to give the struggling borrower the best chance of survival. One option is for the transaction document to include “hell-or-high-water” language requiring one or more of the lenders to divest itself of existing overlapping positions of material influence. A less drastic option may be for the lender with the overlap to drop out of the equitizing consortium, or take a non-influencing stake in the rescued company (for example by way of non-voting preference shares). Clearly, the potential for the competition law tail to wag the restructuring dog needs to be sensitively handled and early and frequent engagement with the appropriate regulator can prevent unwelcome surprises.

But even when there is no overlap, if the EUMR (or another mandatory, suspensory regime) is triggered, this still means the cost, expense and delay of producing and filing a notification and waiting for clearance.

Indeed, analysis of debt-for-equity-type transactions filed with the Commission since 2008 suggests that:

- all were cleared under Article 6(1)(b) (i.e. they were found at phase I not to give rise to serious concerns and so were not opposed); and
- between a third and a half of such transactions were cleared under the simplified procedure.⁵

⁵ The authors note that determination on the basis of publicly available information of whether a particular transaction was in fact a debt-for-equity restructuring of a struggling borrower is not clear-cut. Many such

VII. IMPLICATIONS

The points discussed above throws up interesting questions. At its most stark, there is a case for arguing that debt-for-equity restructurings should be treated as *sui generis* and conceptually different from other concentrations reviewed by the European Commission. They could, for example, be allowed to complete immediately on filing of the Form CO, with the European Commission's enforcement powers⁶ being more akin to that of the OFT in the United Kingdom (i.e. the ability to order a business to be "held separate" if an appropriate legal threshold for competition concerns is met, and ultimately an ability to unwind a transaction). Some major jurisdictions, for example, have adopted a pragmatic approach and have exemptions from merger control rules for this type of deals.⁷

Recognizing that such a change might be seen as radical in Europe, and possibly require legislative change, there are alternative ways to regulate debt-for-equity restructurings in a way that allows competition authorities to continue to function but which does not unduly burden the already-complex restructuring process.

First, as noted above the European Commission has discretion (under Article 7(3) EUMR) to grant a derogation from the suspensory obligation. In practice, there have been relatively few such derogations. The European Commission's published statistics suggest there have been 12 since 2008, although it is difficult for researchers to get more detail since derogation decisions, while reasoned, are not separately published and may well be correlated with simplified procedure clearances. This suggests that the possibility of obtaining a derogation may not be widely appreciated, not least by those advising on restructuring scenarios who may find the possibility of great benefit. European Commission guidance (or guidelines) on the application of its discretion to grant derogations from the suspensory obligation would be welcomed, in particular for lenders whose clients continue to struggle to meet loan repayment obligations.

A second area in which advisors might benefit from a revised approach is around the concept in Article 3(1) EUMR of a "change of control on a lasting basis." Most debt-for-equity restructurings are not entered into at the willing choice of the lender(s), who would much rather wish that the borrower's finances remained on an even keel and that no such measures were necessary. For most lenders the taking of an equity stake is conceived of as a temporary measure and the bank will often be looking to exit as soon as possible. The problem is that there is no identified, legally certain exitroute—no buyer will have been lined up to acquire the restructured business, for example—and so the various tests in paragraphs 30 to 35 of the Consolidated

transactions are cleared under the simplified procedure with limited detailed description of the transaction provided beyond the publication of Section 1.2 of the Form CO.

⁶ A (substantial) difference between this situation and the current U.K. regime would still remain, in that the notification of the transaction would still be mandatory.

⁷ The United States and Canada are examples. In particular, in the United States there is an exemption for certain equity exchanges in the context of debt work-out arrangements. In order to qualify, the debtor and original creditor must have previously entered into a "bona fide credit transaction," and that original transaction must have been "entered into in the ordinary course of the creditor's business." In Canada Ss. 111(d) of the Competition Act exempts from premerger notification "an acquisition of collateral or receivables, or an acquisition resulting from a foreclosure or default or forming part of a debt work-out, made by a creditor in or pursuant to a credit transaction entered into in good faith in the ordinary course of business."

Jurisdictional Notice (which allow the European Commission to look at the ultimate acquirer in, for example, a break-up-bid or interim-buyer context) are not met.

It is of course open to the European Commission to change its policy in this regard. Indeed, the introduction of the current Consolidated Jurisdictional Notice was used to revise policy in relation to “parking” an undertaking with an interim buyer. Lending banks can be expected to welcome a more flexible approach to the concept of “control on a lasting basis” if this reduced the burden placed on restructuring scenarios by merger control requirements.

VIII. APPLICATION OF MERGER CONTROL ON AN EXIT

Assuming that the restructuring is successful, one final issue from a competition law perspective is that the lending (now equity-holding) banks are likely to wish to exit as soon as they can. The consequences of the financial crisis, including in some industries a wave of restructurings, mean that the competition risk associated with that exit may be greater than historically would have been the case. The industry may have become more consolidated, and the number of willing trade buyers may have been reduced. As a result, the equitized lenders may need to consider alternative routes. Management buyouts and initial public offerings (“IPOs”) naturally raise the fewest competition concerns; in the case of an IPO, merger control rules will not apply, and a management buyout can be structured to fall outside merger control rules (at least so far as merger control in the European Union is concerned) if the managers do not form an “undertaking concerned.”⁸

The implementation of most exit strategies will require a traditional jurisdictional and substantive competition law analysis. However, in debt-for-equity swaps there are particular aspects to consider. Some merger regimes take into account the seller’s turnover for jurisdictional purposes: examples include Poland and Brazil. In many instances the seller(s) (the equitized lender(s)) typically have substantial turnover in multiple jurisdictions. It can be a particular frustration for management and for the equitized lender(s) to find that a sale of a small business to a small acquirer, while raising no substantive competition law concerns, must nevertheless be delayed while the parties go to the expense of drafting, filing, and awaiting clearance following a mandatory notification.

IX. CONCLUSION

Restructuring a business in crisis is a difficult and complex process. Stakeholders include lenders, management, employees, customers, and usually multiple regulators. Much is at stake. Unfortunately, merger control rules, by treating debt-for-equity swaps as conceptually no different from other acquisitions, appear to place further obstacles in the path. It is particularly unclear that the costs and risks associated with mandatory suspensory regimes are outweighed by the benefits of preventing potentially anticompetitive deals from closing without review by the competition authorities.

This article does not insist that a radical change in approach is needed. But we do note that regimes which allow completion before clearance, or which allow businesses to self-assess the impact of their deals on competition and manage the risk accordingly, or which have exemptions, are very much easier to do this sort of business in than those regimes that insist that transactions be notified irrespective of the purpose, timetable, or actual substantive threat to

⁸ Consolidated Jurisdictional Notice, ¶ 152.

competition posed. The competition law framework in those regimes is therefore more likely to engage and earn the respect and trust of businesses whose activities involve the rescue and recovery of struggling borrowers.

Against this background, the U.K. government is currently consulting on whether to move from a voluntary approach to merger notification in the United Kingdom to a mandatory obligation. Given the continuing need for restructurings in a climate of economic difficulty, this would be most unwelcome.

Our view, as advisers to a lender playing an active role in assisting companies of varying sizes, is that the current flexible approach in the United Kingdom should be retained. We would also welcome a more flexible approach from the (majority) of regimes worldwide that operate mandatory, suspensory systems. So far as the European Commission is concerned, we would welcome detailed and open guidance on the availability and application of its discretion to grant a derogation.