Economic Nationalism and Merger Control: Impact of COVID-19

By Tanya Macrae[1]
(Avonhurst)

Edited by Anna Tzanaki (Competition Policy International) & Juan Delgado (Global Economics Group)

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Overview

Lockdown restrictions are easing in several European countries, and the "way out" is the key topic of discussion across western economies. As such, questions over the climate for new investment are becoming acute. This note looks at the initial signs of changing attitudes to foreign investment in the EU and UK, and the potential implications for foreign direct investment ("**FDI**") and merger control.

Transactions in the new era will take place against a backdrop of cracks in the European project, a severe economic downturn and job losses. Early indicators are that these are providing a pretext for heightened economic nationalism, last seen in earnest during the eurozone crisis. As distress is expected across sectors, the market imperative for re-priced deals will inevitably fuel concerns over "predatory" acquisitions. Merger control authorities in the UK and EU, among others, have been at pains to stress that review standards will not be more lenient as a result of the crisis.

However, merger control regimes in the EU, UK and US, amongst others, still recognise the "failing firm" defence. Fears over foreign ownership, adjusted asset pricing and market consolidation, will inevitably run up against the economic reality that many firms will be unviable post-crisis without a backer.

Cracks within European Co-operation, and Concern Over Cross-border Takeovers, Supply Chains and Trade

Traditional alliances have been fraying as a result of the crisis. Cracks within European cooperation were initially laid bare by the shortages in medical supplies, with the early refusal of EU Member States to assist Italy in its urgent request for medical equipment, and export bans on key items in many EU countries.[2] This has only escalated with the row over debt mutualisation,[3] including the extraordinary and ongoing row over the German Constitutional Court's 5 May findings of overreach by the ECJ in approval of the ECB's bond-buying programme. The fact that the ECJ and the President of the European Commission, Ursula von der Leyen, have since issued statements in reply in rapid order, underlines its importance.[4]

The significance of this dispute, both for its implications for future bond-buying programmes in the wake of the virus crisis, and for the unprecedented challenge laid down to the primacy of EU institutions, can hardly be exaggerated. That the President has felt the need to state that "[t]he final word on EU law is always spoken in Luxembourg. Nowhere else" is a stark reminder of the scale of the challenge to the EU legal and political order.

Accompanying this assertion of constitutional supremacy, there are indicators of a strong resurgence in economic nationalism, with an attendant lower willingness to rely on foreign trading partners. Comments from leaders such as France's President Macron and finance minister Bruno Le Maire reflect this. Le Maire, for example, was quoted on 31 March 2020 as saying that France's reliance on China and the rest of Asia, not only for "strategic" goods such as aerospace and medical, but also for supply chains more broadly, should cease in the longer term.[5]

Changing attitudes were initially fuelled by reports of the attempted US acquisition of German medical company, CureVac, with the attendant concern that the company's potential Covid-19 vaccine could end up being deployed to the benefit of the US alone.[6] However, the issue has now grown well beyond the medical aspect; concern has spread that complex cross-border supplies are a source of vulnerability. The Financial Times perhaps exaggerates the point when it refers to "the decline of global supply chains" as one of the long-term implications of the virus.[7]

Covid has only accelerated existing trends towards the resurgence of economic nationalism in Europe. Following 2016's Brexit vote, we already saw the ascendancy of EU voices calling for tighter restrictions on the sale of strategic European assets, given the declining influence (and ultimate removal) of the UK's traditionally free-market voice from the bloc. There have long been calls from France and Germany – renewed in strength following the EU's February 2019 prohibition of the Siemens/Alstom merger, for example – for a strategic approach to EU merger policy allowing for the creation of so-called "European champions". These forces will be redoubled in a more protectionist post-Covid environment, with the increased emphasis placed on national self-sufficiency, mistrust of former partners such as China, and likely widespread re-shoring.

Proponents of trade liberalisation will also increasingly find themselves facing opposition, in the guise of a range of interests. Witness the joint statement from the French and Dutch trade ministers reported on 4 May, for example, to the effect that third countries not meeting EU environmental and labour standards should face tighter trade restrictions.[8]

European Commission Concern Over "Predatory Foreign Takeovers" Following Viral Economic Damage

Despite the serious potential implications of the tailwinds of the crisis for the European project, the European Commission has sought to keep something of a sense of normalcy in substantive merger control. The Commission has emphasised that review standards will not be relaxed, even as it runs a more limited service, partly remotely, with concomitant longer investigations. However, the strengthened thread of economic nationalism also runs through this narrative.

It is a measure of the panic which prevailed as lockdowns were announced across Europe in late March and early April, that the guidance paper issued by the European Commission on 25 March 2020[9] has garnered comparatively little attention. The "Communication from the Commission" urges EU Member States to use foreign direct investment (FDI) screening powers to protect "strategic assets" from what it terms "predatory buying" by "foreign" investors. The paper follows the entry into force of Regulation (EU) 2019/452 of March 19, 2019, establishing a framework for FDI screening into the EU and the ongoing related amendments and enhancements of FDI rules at national level.

The guidance paper appears to be saying that "predatory" acquisitions in principle include those which come from "third countries" (i.e., non-EU - so potentially including the UK, post-Brexit) "with valuations… that are considered well below [the] true or

intrinsic value [of the EU-based target]". The difficulty of assessing "true or intrinsic value" in an economic landscape which has changed beyond recognition is not discussed. Many will also find the notion that national governments are best placed to determine "true or intrinsic value" of companies, hard to swallow.

The Commission refers to a wide range of interests as potentially worthy of protection through FDI controls. These range from the more obvious (ensuring financial stability, protecting public health, ensuring the provision of essential public services), to the very broad and vague, such as protecting consumers, "preserving the financial equilibrium of the social security system", and "achieving social policy objectives". This type of language marks a serious departure in EU policy – away from open markets and a focus on effects on market competition, and towards a vastly wider range of socio-economic concerns.

To look at how this could play out, imagine a proposed transaction in which a non-EU investor – say, a US fund – values a large nationwide non-food retailer, e.g., in an EU Member State at today's (post-Covid) values. Implementation of the transaction will involve a radical restructuring plan, with the shedding of large numbers of jobs as the company pivots to an online-only offering. If the EU's guidance were followed by Member States, it is not too remote to envisage the deal being blocked on the basis that the mass redundancies are contrary to "social policy objectives", or could threaten "the financial equilibrium of the social security system".

Failing Firm Defences

Against this nationalist/protectionist trend, is the overriding practical consideration: "predatory foreign" acquisitions may well be viewed as preferable to mass corporate insolvencies or further bail outs of sectors by hard-pressed national governments. This is particularly so given that some sectors may be unsustainable without radical change. Many will find it difficult to imagine this happening under public ownership.

It is worth noting that both the EU and the UK recognise a so-called "failing firm" defence in merger control – whereby an acquisition, which would usually be blocked (or required to be amended) for its substantive effects on competition, can be cleared if it can be shown that the alternative is the insolvent exit of the target company and its assets from the market.

In normal conditions, such defences are hard to make out; the would-be buyer may be required to show no more suitable buyer is available and restructuring absent the proposed transaction is unviable. The UK's Competition and Markets Authority, and the European Commission, have each put out statements in recent weeks stressing that the usual standards of review and for the application of the "failing firm" defence remain stringent and unchanged. However, clearly, the "failing firm" tests are far more likely to be met in transactions across sectors, post-Covid.

"Failing firm" is typically a defence against substantive merger control concerns – rather than having an explicit role in FDI reviews (the focus of the Commission's 25 March paper, as above). However, a persuasive failing firm defence made out in the merger control proceedings on a given deal is likely to influence any FDI review of the

same transaction. FDI reviews are fundamentally political, and bigger picture fears over control of national assets will inevitably be weighed against the often bleaker policy implications of the insolvent counterfactual.

Impact of Brexit: UK Attitudes

Public disquiet over the UK's historically relaxed attitude to cross-border acquisitions of iconic UK companies gained momentum with Advent's acquisition of Cobham in January 2020. Controversy also surrounded the 2016 acquisition of Arm Holdings by SoftBank, as well as Kraft's 2010 acquisition of Cadbury, and alleged broken promises regarding factory closures in its aftermath. In a July 2018 White Paper, the May government proposed a radically wider approach to FDI reviews in UK merger control[10]. The announcement of the proposed National Security and Investment Bill in December 2019 suggests that the Johnson government is on track to take a similar approach.

In addition, Johnson's team is reportedly keen to ensure that it continues to implement its "levelling up" agenda as it rebuilds the UK economy in the aftermath of the Covid crisis. There will be an urgent need to support the Conservative Party's new, blue-collar voter base, hard-hit by the UK's lockdown. As such, there is some suggestion that we could see additional hurdles in UK merger control, designed for example to safeguard employment. Established merger control regimes, such as that of South Africa, already give a key role to the impact on employment in the assessment. Legislative changes in the UK and elsewhere in Europe could see companies asked to give guarantees on maintaining jobs, as a condition to clearance. A rebalancing of the UK economy towards the public sector, could also see a shift towards a more interventionist view of the government's role in stewarding the economy – including through merger control and more intensive FDI reviews.

Conclusion

In the short term, buying activity remains subdued, as the full effects of the pandemic on asset pricing are yet to crystallise. Governments are also overwhelmed in dealing with the immediate impact of the virus. For the time being, central interventions in merger control could take a back seat for all but the most sensitive acquisitions (such as that of Cure-Vac, as illustrated above).

However, merger review processes are being elongated by the practical difficulties caused by the pandemic. "Pre-notification" talks with regulators can be extended indefinitely, the additional time also giving scope for the launch of new FDI reviews. The full implications of the changed climate for foreign investment in the EU and UK are likely to materialise over the coming months and years, but the initial phases of that climate's cooling are already well apparent.

[1] Tanya Macrae is an Associate at Avonhurst, an advisory firm focused on delivering solutions for sophisticated capital clients. Avonhurst combines legal, geopolitical risk advisory and capital introduction capabilities, transcending legal frameworks to provide multidisciplinary thinking.

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