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Succeed in M&A in Times of Heightened Regulatory Scrutiny

How to understand the new regulatory challenges for M&A transactions and to navigate these challenges successfully

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After several months of slowdown, triggered by increased interest rates and macroeconomic uncertainty, the second half of 2024 is expected to see a resurgence of M&A activities. Corporates are bound to adjust to market challenges by redefining their business models, driving innovation and synergies through acquisitions and optimizing their resources through carve-out and divestments. Financial sponsors are under increasing pressure to streamline their portfolios through buy-and-build strategies and to create returns for their investors through exit sales and secondary transactions.

The expected resurgence of M&A activities, whether by corporates or financial sponsors, will, however, face the headwind of heightened regulatory scrutiny. In recent years, the merger and foreign investment control regimes in many jurisdictions have been expanded and regulatory authorities have stepped up their efforts of robust enforcement. This creates new challenges for M&A transactions. More transactions become regulatorily critical, and more thoughts and efforts are necessary to bring those transactions across the regulatory hurdles.

In the following article, we will highlight these regulatory challenges, analyze their impact on M&A transactions and provide guidance for transaction parties on how to navigate these challenges successfully. As we will show, with a good understanding of the regulatory concerns, a clear regulatory roadmap and smart transaction planning and implementation, M&A transaction parties will be able to cope with this those challenges and still be in a position to bring transactions home, even against regulatory headwinds.

With thanks to my colleagues Jannan Crozier and Samantha Mobley (London), Gavin Bushell (Brussels) and Creighton Macy and Brian Burke (Washington DC) for their contribution to this article.

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Increased regulatory scrutiny

In recent years, M&A transactions have faced heightened regulatory scrutiny. Antitrust authorities have tightened the grip of merger control, foreign investment control has been expanded and in the European Union a new regulatory regime concerning foreign subsidies has been introduced.[1] Having a well thought-through and detailed "roadmap" for navigating the regulatory challenges is therefore becoming essential for M&A success.

Until a decade ago, regulatory constraints had rarely been a concern for M&A transactions – limited to a handful of cases each year – and outright prohibitions were confined to a low single-digit number of cases each year.[2] Merger control authorities for the most part handled transactions in a deal-friendly manner. Whilst regulatory filings involved effort, and some transactions were closely scrutinized, except for very critical cases, the filings resulted in clearance decisions for transactions. Foreign investment control was limited to highly sensitive areas, such as the nuclear energy or defense sectors. Foreign subsidies control was unknown.

This limited approach to challenging M&A transactions began to change in 2016, as part of a development of the global political and macroeconomic environment with rising skepticism about globalization and open markets and an increasing focus on national security and economic protectionism. In the US and Europe, political discomfort arose from the sell-out of critical industries to investors from China and other countries. In Europe, French and German politicians started to discuss how to best protect what they saw as important national assets. With the election of President Trump in the US and the Brexit in the UK, these various tendencies intensified in an increasingly complex political and macroeconomic climate. Later, the COVID pandemic, and most recently the wars in the Ukraine and the Middle East and their impact on the global economy, fueled this skepticism further, by revealing in particular the vulnerability of national and global supply chains.

In response to these political and macroeconomic developments, legislators and regulators around the globe have been heightening regulatory scrutiny of transactions. They broadened and tightened existing regulations and created new regulatory requirements. This significantly changed the playing field for international M&A transactions.

[1] Regulation (EU) 2022/2560 of the European Parliament and the Council of 14 December 2022 on foreign subsidies distorting the internal market (the "Foreign Subsidies Regulation" or "FSR") which started to apply on 12 July 2023, available at: https://eur-lex.europa.eu/eli/reg/2022/2560/oj.

[2] For statistics in Europe: https://competition-policy.ec.europa.eu/document/download/4b083559-e36c-44c2-a604-f581abd6b42c_en?filename=Merger_cases_statistics.pdf)

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Merger control

Broadening of scope and tightening of enforcement

After many decades of what some might say was lenient antitrust enforcement, most relevant jurisdictions have through the last years expanded the scope of merger control, tightened merger control requirements and increased scrutiny of transactions.

Regulators have been increasingly conscious of what is seen as an uncomfortable link between highly concentrated markets and reductions in customer alternatives.

Increased focus on new theories of harm

The focus of merger control has been broadened from traditional horizontal market-share analysis to new perceived threats for competition in different forms, such as potential entry, conglomeracy, ecosystem-strengthening, innovation theory of harm, killer acquisition, self-preferencing, access degradation and other vertical concerns, especially in sensitive sectors such as the digital or healthcare industries.[3] As a result, more transactions, in particular vertical or conglomerate or ecosystems transactions, fall under the scope of merger control and encounter challenges.

Protection of innovation

Merger control authorities have turned their focus in particular on innovation concerns.[4] Not only are they concerned to ensure that pipeline overlaps are properly assessed, but that conditions of nascent innovation are preserved (i.e., the innovation that has yet to result in pipeline products). As a result, more agencies are either relying on voluntary pull-in powers, or amending their rules, to attack transactions that typically would not meet traditional turnover-based merger control thresholds.

[3] See for the EU already the 2014 White Paper "Towards more effective EU merger control" (COM(2014) 449 final), available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014DC0449 and most recently the 2022 European Commission policy brief "Merger enforcement in digital and tech markets", available at: https://op.europa.eu/en/publication-detail/-/publication/e3e58b6d-7b68-11ed-9887-01aa75ed71a1/language-en/format-PDF/source-307979412. For the UK, see the CMA Merger Assessment Guidelines of 18 March 2021, available at: https://www.gov.uk/government/publications/merger-assessment-guidelines. For the US, see the draft Merger Guidelines of the DoJ and FTC of 19 July 2023, available at: https://www.ftc.gov/legal-library/browse/ftc-doj-merger-guidelines-draft-public-comment.

[4] See for the EU "The Role of Innovation in Enforcement Cases – Note by the European Union" to the OECD of 22 November 2023, p. 12 et seq., available at: https://one.oecd.org/document/DAF/COMP/WD(2023)85/en/pdf. For the US, see e.g. remarks of the FTC Chair *Lina Khan* at the Charles River Associates Conference "Competition & Regulation in Disrupted Times" on 31 March 2022 in Brussels, available at: Remarks of Chair Lina M. Khan at the Charles River Associates Conference, Competition & Regulation in Disrupted Times in Brussels, Belgium | Federal Trade Commission (ftc.gov) and article by *Alden Abbott*, former General Counsel of the FTC, "Mergers and Innovation: DOJ and FTC Take Heed" of 15 February 2023, available at: https://truthonthemarket.com/2023/02/15/mergers-and-innovation-doj-and-ftc-take-heed/.

Innovative companies are often not yet sufficiently large to meet the required turnover thresholds. In 2014, e.g., the EUR 19 billion acquisition of WhatsApp by Facebook did not trigger a mandatory review by the European Commission (and the Commission had to rely on three member states referring the case up to it). Increasingly, the European Commission and other merger control authorities became concerned that important transactions were thus 'falling through the cracks' – resulting in future competitive harms that could not be attacked under traditional merger control laws. The assertion was that large tech and other players were taking out the competition before it had even hatched from the shell - so-called "killer acquisitions" or "reverse killer acquisitions" (where the transaction allows the acquirer to "kill" its own inventions and replace them with that of the Target).

Concerns about this development prompted different reactions by the legislators and regulators.[5] In certain jurisdictions, e.g. Germany and South Korea, new triggers for mandatory filings were introduced into the merger control laws which look not only to turnover but to transaction value, as reflected by the consideration paid for the target business.[6] If the consideration for a business with small sales is high, this may be seen as an indication of an innovative company and trigger a merger control filing.

A different path has been taken by the EU. In the merger case *Illumina/Grail*, which was a merger of two US companies that did not reach any EU-wide or national merger control turnover threshold, the European Commission nevertheless exercised jurisdiction by changing its policy on the use of the referral provision in the European Merger Regulation (Art. 22 EUMR). This provision gives the European Commission jurisdiction over a merger if one or several member states refer the merger to the European Commission (even if national merger laws are not triggered) because of the concern that the merger threatens to significantly affect competition in those member states (and the deal also affects trade between member states). In 2022, the General Court of the European Court of Justice (ECJ) confirmed the view of the European Commission that the referral of the *Illumina/Grail* merger to the European Commission was permitted, even though the merger did not reach EU-wide or national turnover thresholds.[7] This applies even if the transaction has already been closed. The General Court judgment is under appeal to the EU's highest court. It remains to be seen whether the ECJ will uphold the position of the European Commission to pull in deals under Art. 22 EUMR even when no national merger control filings are triggered (and the EUMR thresholds are not met) so long as the test in Art. 22 EUMR itself is met. A recent Advocate General Opinion has suggested that the ECJ should not uphold the European Commission's position.

Whilst the outright number of cases that could be potentially subject to an Art. 22 EUMR pull-in risk is limited (and limited to perhaps certain sectors such as tech and bioscience), it remains a serious risk that parties need to consider appropriately if the circumstances appear fitting. The *Illumina* case has created uncertainty whether acquisitions of innovative companies or companies that are critical for a supply chain will be subject to EU merger control, even if not falling under applicable thresholds. Inevitably, this will lead to further negotiations between merging parties and their advisors as to how to manage the risk and what happens if indeed their case is pulled in for review. In a paper of 2021, the European Commission tried to provide guidance regarding its intended use of Art. 22 EUMR (it did so

[5] See for the EU speech by EVP Vestager at the International Bar Association 26th Annual Competition Conference in Florence "Merger control: the goals and limits of competition policy in a changing world" on 9 September 2022, available at: Speech by EVP Vestager at the IBA Competition Conference (europa.eu).

[6] In Germany, see para 1a of Article 35 of the Act against Restraints of Competition (Gesetz gegen Wettbewerbsbeschränkungen – GWB), available (in German and English) at: https://www.gesetze-im-internet.de/englisch_gwb/index.html.

[7] Case T-227/21; see press release of the Court of Justice of 13 July 2022, available at: https://curia.europa.eu/jcms/upload/docs/application/pdf/2022-07/cp220123en.pdf and the full text of the judgement at: https://curia.europa.eu/juris/documents.jsf?num=T-227/21.

to legitimize its position in the then pending *Illumina* case).[8]

In many transactions involving innovative or supply-critical companies, the merger control analysis of the parties can thus no longer stop at an assessment of turnover and market shares. The possibility of a referral under Art. 22 EUMR must be considered – and the same consideration must be given to other jurisdictions with such pull-in powers. Informal clearance with the European Commission and/or relevant national merger authorities might have to be sought.

Merger control regimes around the world are increasingly active

The tendency to expand and tighten merger control has not been limited to the main business-center jurisdictions where merger control has typically been enforced. Merger control is now a truly global phenomenon with active regimes in over one hundred countries. China, e.g., introduced merger control in 2008 and significantly amended it in 2022. The amended rules give the authority more flexibility to "stop the clock" and provide for higher fines, especially for gun-jumping. Egypt moved in 2022 from a light-touch, post-closing notification regime to a tight mandatory-clearance requirement (with implementing regulations coming into force of June 1, 2024). Australia is proposing a mandatory-clearance regime. Turkey introduced in 2022 a new authorization regime for transactions involving technology with R&D or supply of customers in Turkey.

Authorities outside the main Western jurisdictions also increasingly recognize the power which merger control gives them over international companies and transactions. Merger authorities in developing markets, in particular in Africa, have started to actively monitor the market for transactions that fall under their filing requirements. This should prompt the parties in international transactions to identify filing requirements and make filings with particular diligence.

Tightening the merger review and enforcement

In their review of transactions, the merger authorities are becoming more demanding and more critical.[9] Information requests to the parties and inquiries about transactions with market participants are not only increasing but are increasingly burdensome, often requiring the submission of large amounts of data and internal documents. In the *Bayer/Monsanto* case, e.g., the European Commission compelled disclosure of over 2.7 million documents from the parties.[10] In cases where market definition (or the size of the parties) is in dispute, the European Commission will routinely engage in a "market reconstruction" exercise, pulling data from the entire industry, to model the effects of the notified transaction on competition. All of this of course makes merger control proceedings lengthier, more burdensome and more costly for the parties. In complex cases (e.g., in Europe, roughly about 6% of cases notified to the European Commission) this means that regulatory scrutiny is very intense and can have a material impact on any deal timetable. Some merger cases can take almost two years to be cleared. In the UK, e.g., from 2019 to 2022 the percentage of transactions unconditionally cleared by the Competition and Markets Authority after Phase I proceedings dropped from 64% to 30%, the number of transactions referred to Phase II has increased from 22% to 35% and the number of transactions blocked or abandoned has increased

[8] Communication from the Commission Guidance on the application of the referral mechanism set out in Article 22 of the Merger Regulation to certain categories of cases 2021/C 113/01 of 31 March 2021, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021XC0331%2801%29.

[9] For the EU, see EU Merger Cases Statistics of 1 February 2024, available at: https://competition-policy.ec.europa.eu/mergers/statistics_en.

[10] See press release of the European Commission "Mergers: Commission clears Bayer's acquisition of Monsanto, subject to conditions" of 21 March 2018, available at: https://ec.europa.eu/commission/presscorner/detail/en/IP_18_2282.

from 11% to 30%.[11] This means that having a comprehensive and well-thought out regulatory roadmap is essential for M&A success.

Stricter requirements for remedies

Traditionally, competition concerns raised by a merger have often not resulted in a prohibition of the merger, but instead the parties are usually able to offer commitments to remedy the concerns. In recent years, however, the merger authorities have become increasingly skeptical about remedies, noting that they often fail to preserve the pre-merger competition conditions.

Preference for divestments over behavioral remedies

Behavioral remedies, as, e.g., supply commitments or licenses of technology to competitors as a remedy for anti-competitive mergers have long been regarded with skepticism. Such commitments are in most cases not considered sufficient to remedy the anti-competitive effects of a transaction – even though accepted in a limited number of cases, for example, after an in-depth Phase II investigation. This was the case in the recent EC approval of Microsoft/Activision Blizzard, where the EC accepted a free license to consumers in the EEA that would allow them to stream, via any cloud game streaming services of their choice, all current and future Activision Blizzard PC and console games for which they have a license; and (ii) a corresponding free license to cloud game streaming service providers to allow EEA-based gamers to stream any Activision Blizzard's PC and console games.

Generally, however, the EC's strong preference remains that remedies must encompass the divestment of parts of the target business or even of the existing business of the purchaser.[12]

Even in the area of divestment remedies, the requirements by the merger authorities have become stricter. To remedy competition concerns, it is in many cases no longer sufficient to divest individual assets, products or contracts. Instead, the divestment must now typically encompass an entire business that is separable, with no enduring dependence on the merging parties and perhaps include a broader set of assets beyond the product/services at the heart of the concern. Such business must be stand-alone, separate, with a clean break, from the target business, and economically viable, and (most importantly) capable of preserving robust competition within the relevant market.[13]

Challenges for a successful antitrust-triggered divestment

Preparation of a stand-alone and economically viable divestment business

In order to be stand-alone, a divestment business must typically comprise all the assets and business functions, and in some cases may also require the inclusion of full-scale central functions such as accounting, finance, HR, IT and R&D. While some form of transitional support may be required (and permitted) for some increment of time following closure of the divestiture transaction, the central functions ultimately must be available in the divestment business itself if it is deemed necessary by the merger authorities.

[11] Merger Inquiry Outcome Statistics of the CMA, available at: www.gov.uk/government/publications/phase-1-merger-inquiry-outcomes.

[12] For the EU, see already "Commission notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004" of October 22, 2008, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52008XC1022(01). For the US, see Guidance Statement of the FTC "Negotiating Merger Remedies" of January 2012, available at: https://ftc.gov/advice-guidance/competition-guidance/negotiating-merger-remedies. For the UK, see CMA Merger Remedies Guidance, no. 5 et seq., available at: www.gov.uk/government/publications/merger-remedies.

[13] See references in Fn. 12.

Given the highly integrated nature of most corporate groups, the set-up of a stand-alone divestment business with full central functions will likely be a challenge and often be economically suboptimal for the parties. Shared services and central departments will have to be split between the remaining target business and the divestment business. This might require the hiring of additional headcount and will have an impact on the business plan and profitability of the remaining target business and potentially also of the divestment business. A negative impact on the divestment business could make the divestment remedy unfeasible to potential divestment buyers and therefore to the merger authorities.

At the same time, if the divestment buyer is a large group with its own central functions, the requirement of central functions in the divestment business might lead to a duplication of functions, which could trigger subsequent downsizing and redundancies. The impact will be less in the case of a financial investor as divestment buyer, because the financial investor as divestment buyer will most likely demand a set-up of the divestment business as a stand-alone business in any case. The requirement of a clear delineation of the divestment business from the remaining target business requires that most operational relationships between them be terminated. Again, in highly integrated groups, with numerous internal manufacturing, supply, marketing, sales and R&D relationships, this can be a significant challenge. All existing relationships, in both directions, must be identified, reviewed and replaced by stand-alone arrangements which meet third-party arm's length standards. Generally, regulators will also want to limit these arrangements to transitional supply conditions, so as to ensure that the divestment business is not dependent on the parties making the divestment. Whilst longer-term supply agreements for essential utilities can be put in place, the cross-supply of raw materials, intermediates and even finished products or services beyond three years can raise concerns about on-going links between competitors and the independence and viability of the divestment business. This, again, could have an impact on the business plan and profitability of the remaining target business and potentially also the divestment business.

The requirement of economic viability relates to many economic aspects of the divestment business: business model, innovation, sourcing, manufacturing, distribution, management etc. In order to provide the divestment business with a viable business case, the divestment might have to include assets or activities beyond what is required to resolve the competitive concerns, including in regions beyond the relevant merger clearance jurisdictions. This is particularly the case with important IP rights, which the regulators will generally wish to see transfer to the divestment business (globally to the extent they relate to the divestment business), with the possibility of a licence-back of rights on certain terms. All of this can have an adverse value impact on the remaining target business if not managed carefully.

Identification of a divestment buyer

The merger authorities also review carefully the identification of a divestment buyer as the "remedy taker". In order to be accepted as the purchaser of a divestment business, a buyer must have the necessary resources, expertise and incentives to operate and maintain the divestment business on a viable basis, and not raise any prima facie competition concerns.[14] These requirements cause a natural tension for buyers, which needs to be carefully managed – having expertise means having relevant activities that could create competition concerns. This often can disqualify potential buyers who are material competitors of, or in a material vertical relationship with, the divestment business. An offer to remove competition concerns by the divestment buyer giving its own remedies is usually not workable, particularly if the remedy is being given at the end of the first investigatory phase, but there

[14] See references in Fn. 12 and for the US the FTC guidance "A Guide for Potential Buyers: What to Expect During the Divestiture Process"), available at: https://www.ftc.gov/system/files/attachments/merger-review/a_guide_for_potential_buyers.pdf.

are a handful of cases where a divestment buyer has been approved subject to it offering remedies (such as in *Bayer/Monsanto* [15] and *BASF/Bayer Divestment Business*[16]).

It should also be noted that the threshold for "prima facie competition concerns" is much lower than the threshold to intervene in a merger case at the European level ("serious doubts" in Phase I and "significant impediment to effective competition" in Phase II). Careful attention is required to pressure-test the antitrust assessment provided by any potential remedy buyer with any activities in the same area as the divestment business, or in any area neighboring, or upstream or downstream of them. Regulator prima facie concerns will more likely be created where third parties are motivated to complain about a divestment buyer (and in an auction process for a divestment business, it cannot be excluded that disgruntled bidders may seek to "play games").

Opportunities for private equity buyers

Private equity buyers usually do not raise competition concerns (unless they have a competing business in their investment portfolio), but can be met with skepticism because of their short investment horizon and associated lack of an enduring commitment to the divested business and potentially limited financial viability. [17] However, larger private equity investors with solid financing, a proven track record and experience in the relevant industry can and do succeed.

For private equity buyers, opportunities as divestment buyer could present an interesting investment proposition. Traditionally, private equity buyers have been hesitant to engage in the late stage of an auction if there is strong competition by a strategic buyer. However, in a divestment transaction where acceptance of a strategic buyer by the merger authorities is uncertain, the seller will likely welcome a back-up deal with a solid private equity buyer as an "insurance protection" against the deal with the strategic buyer being rejected by the authorities. With a reasonable fee for such insurance protection, the back-up deal will be a win-win for the private equity buyer: If the deal of the seller with the strategic buyer is rejected, the back-up deal will become an actual deal for the private equity buyer. If the strategic deal goes through, the private equity buyer will at least receive the fee for the back-up deal as a coverage of its cost and a small margin.

Divestments involving local assets, products or contracts have traditionally often been made to local or regional divestment buyers. From a competition perspective, this is beneficial, as it stimulates competition on a local or regional level. The requirement of a stand-alone divestment business, however, makes a divestment to a local or regional buyer less feasible if the central functions in the target group required for the stand-alone business are integrated global functions and cannot, or only with unreasonable efforts, be split-off locally or regionally. The divestment of a stand-alone business will thus often be possible only to a single global divestment buyer who is willing to acquire the entire divestment business globally. This could narrow the scope of potential divestment buyers to large globally active strategic or financial investors. Those large global investors are, however, often likely to raise competition concerns. These conflicting requirements can make the search for a suitable divestment buyer challenging. However, with a well-prepared and carefully managed auction process, supported by advisors with cross-border transaction and carve-out experience, the identification of a global divestment buyer should be possible.

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[15] See Fn. 10 and the clearance decision of the European Commission of 29 May 2018 (Case M.8084), available at: https://competition-cases.ec.europa.eu/cases/M.8084.

[16] See clearance decision of the European Commission of 14 February 2019 (Case M.8851), available at: https://ec.europa.eu/competition/mergers/cases1/20215/m8851_1288_3.pdf.

[17] See references in Fn 12.

Divestment process

Divestment remedies also have become more difficult procedurally, both with respect to the remedy design as well as with the selection of the divestment buyer in the framework of the merger clearance process.

With respect to the remedy design, it is important to note that there are significant differences between the merger control practices in the relevant jurisdictions. [18] The traditional approach of the European Commission and national European merger authorities has been sequential: merger clearance is granted subject to the divestment of critical parts of the target business within a given period after closing. The selection of the divestment buyer and consummation of the divestiture transaction may then happen within a set period of time after the purchaser has taken control of the target. This makes divestments easier to implement.

In critical cases, however, e.g., if the merger authorities have doubts regarding the viability of the divestment business or the availability of an acceptable divestment buyer, the authorities can require the divestment to be signed or even implemented prior to the closing of, or even prior to the granting of merger clearance for, the main transaction. There are essentially three variations: (i) the "upfront buyer" scenario, where the parties to the main transaction obtain their merger clearance, but commit that they will not implement the main transaction until the authorities have approved the divestment buyer and the signed transaction document for the divestment; (ii) the "fix-it-first" scenario, where the parties to the main transaction sign and implement the divestment with a third party prior to seeking the merger clearances for and the closing of the main transaction (particularly relevant in the US); and (iii) the "hybrid fix-it-first" scenario, where the parties to the main transaction offer an "upfront buyer" condition to the authorities, but significantly advance the presentation of the divestment buyer and the transaction documents with the authorities in parallel to seeking the merger clearances for the main transaction, so that the divestment buyer can be approved very quickly after the main transaction is approved. The latter is particularly used by the European Commission.

Difficulties in identifying a suitable divestment buyer are aggravated by uncertainty regarding the process of the divestment buyer approval by the merger authorities. In some jurisdictions, there is no legally prescribed process, but the merger authorities handle the divestment buyer approval on a case-by-case basis according to their individual discretion and policy.

Divestment buyer approval usually involves a full vetting of the proposed buyer, with significant amounts of information and documentation to be exchanged and discussed with the authorities. The merger authorities are often hesitant to undergo the vetting process before the divestment remedy is sufficiently clear and the discussions with the divestment buyer are sufficiently advanced – particularly if multiple potential buyers remain in the process. Their clear preference is to deal with only one buyer, as this reduces the amount of review required by them (although we do have experience of certain authorities dealing with more than one prospective buyer). Most merger authorities are not willing to vet more than one buyer at a time. A clear statement about the intent of the proposed divestment buyer is required and, in critical cases, a fully negotiated purchase agreement must be submitted. A further complication in this area is that the authorities will want to deal with the divestment buyer and their counsel bilaterally – without the main parties and their counsels involved – and this can lead to a certain lack of control of the process for the main parties (as well as increase the risk of further delays in the process).

[18] See references in Fn 12.

Involvement of a trustee

In order to assure that a divestment is made in accordance with the commitments given in agreement resolving the substantive review, the merger authorities may appoint a third party as a trustee to monitor the divestment business and process. The scope of involvement of the trustee in the divestment varies, depending on the requirements imposed by the merger authorities. In less critical cases, the role of the trustee is limited to monitoring the divestment process and reporting progress to the merger authorities. If a divestment buyer cannot be found within a prescribed period, the trustee can (if mandated by the parties) take on the role of the divestment seller and makes the divestment itself (although this is very rare in practice). In any event, the involvement of the trustee is an additional procedural factor which the transaction parties must take into account in structuring the transaction process – and the process can be influenced by the nature and the behavior of the trustee.

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Multiplication of challenges in international transactions

The challenges regarding the planning and implementation of a divestment remedy can increase in an international transaction, exponentially with the number of jurisdictions involved where remedies are required.

Identification of a universally acceptable divestment buyer

Regarding the selection of the divestment buyer, the merger authorities in various jurisdictions may have different preferences, depending on their strategic priorities and enforcement policies. The European Commission and the national merger authorities in the EU member states and the UK will carefully analyze in a formal process whether strategic buyers pose a potential competition issue when combined with the divestment business but usually have no objection to private equity sponsors as divestment buyer as a matter of principle. In the US, the regulators adopt a less formal approach to assessing the antitrust risks posed by potential divestment purchaser but are more skeptical about private equity remedy takers. If a global divestment buyer must be approved by several merger authorities, the identification of a buyer that satisfies all merger authorities can be a complex process that needs to be navigated proactively in order to succeed.

The need to have the divestment buyer approved by multiple authorities can make it difficult to select the divestment buyer through an auction process. The divestment buyer that is considered suitable by the authorities might not be the highest bidder for the divestment business. The highest bidder might raise competition concerns (because its pricing builds in evident synergies – synergies which may arise from overlapping activities that could present competition concerns). Often the main purchaser as divestment seller will have no choice but to present to the merger authorities the auction bidder with the greatest chance of acceptance in the hope that such bidder will be accepted by the authorities. This changes the focus of the auction away from value towards deal certainty.

Globally aligned process and timeline

A particular challenge in an international transaction is to agree with all relevant authorities on a globally aligned process and timeline which enables the identification of the divestment buyer and the preparation and implementation of the carve-out and divestment in accordance with the requirements of all authorities. The problem is that each authority naturally follows its own procedures and there is no formal process for collaboration on timing among different authorities. What international policies that exist today (across the Atlantic, for example), are limited to expressions of "best practices" or intent rather than strong commitments on cooperation and timing. In appropriate situations, however, it is possible for the parties to foster timing alignment and collaboration. If the parties present to the authorities a workable timing concept that meets the requirements of all authorities, it may be accepted by the authorities.

Challenges of the reverse carve-out

The requirement of a stand-alone divestment business might result in a need to structure the separation of the divestment business from the retained part of the target business as a reverse carve-out (and this appears to be a preference for certain authorities given the cleaner approach).

In a reverse carve-out, the divestment business will remain in the target group entities. Those entities will then be divested in the form of a share deal. The retained parts of the target business, which the main purchaser is permitted to acquire, will prior to or concurrently with the share deal be carved out either to newly established companies (NewCos) or at closing directly to the purchaser of the main transaction or its local affiliates. The benefit of this structure to the divestment business is that the divestment business retains the legal entity and all assets that are needed to operate. This should satisfy the requirement of the antitrust authorities of a stand-alone divestment business. The burden is on the main purchaser and the retained part of the target business to carve out from the target business what they need for the retained part and what they are permitted by the antitrust authorities to retain.

A reverse carve-out can create particular complexity where within a legal entity the retained part of the target business is the larger part of the target business. This turns the acquisition of the target business by the main purchaser from a share deal into an asset deal. Consideration will need to be given as to how to manage areas such as employment consultations within the regulatory timeframe, cash repatriation when carving out the larger part of the business and how to deal with transferring subsidiary shareholdings out from entities that will transfer with the divestment business.

Reverse carve-out from a global business

In a global target business, with subsidiaries and business operations around the world, the reverse carve-out can trigger the need to carve-out from the target group shares or assets in numerous jurisdictions. This is the case, e.g., if the relevant antitrust concerns and thus the need for a divestment is limited to a small number of economically important jurisdictions, while in the larger number of jurisdictions the transaction is not antitrust-critical. The reverse carve-out will then involve a large number of share or assets transfers which might require approvals by local authorities or trigger transfer taxes or taxable capital gains. If the shares or assets to be carved-out are held in cooperation with local joint venture partners, the carve-out might require their consent or support with required corporate actions.

Virtual reverse carve-out

If the reverse carve-out cannot be full implemented within the timeline agreed with the antitrust authority for the divestment, the parties can try to agree for the interim period on a "virtual" reverse carve-out. This means that the shares or assets to be carved-out remain in the target group until they can effectively be transferred. During this period, the main purchaser and the divestment purchaser put each other economically in the position as if the carve-out had already effectively occurred. A virtual carve-out of shares is not overly complicated because the economic results of the business of the relevant company remain in the company (protected by a "no leakage" arrangement) and pass over to the divestment purchaser once the transfer of the shares becomes effective. A virtual carve-out of assets is more complicated. It requires a contractual mechansim that allocates the profits and losses attributable to the carve-out assets for the interim period to the divestment purchaser.

4

Foreign investment review (FIR)

Another regulatory hurdle which is increasingly creating challenges for international M&A transactions is foreign direct investment (FIR) review. In the US, FIR is administered by the inter-agency Committee on Foreign Investment in the United States (CFIUS)[19], in the UK by the Investment Security Unit (ISU)[20] and in the EU by various national foreign trade authorities, oftentimes the ministries of commerce or the economy.[21]

Similar to the developments of merger control, in recent years many jurisdictions have expanded and tightened their FIR regimes.

Expansion of scope of FIR

Until a couple of years ago, transaction parties rarely had to worry about FIR. Only a narrow scope of transactions, involving businesses and assets in e.g., the defense, nuclear or other technology sectors of direct relevance for the national security, were captured. However, similar to the developments regarding merger control, this changed with the geopolitical developments starting in 2016. Increasing protectionism and a wide concern in the US and EU regarding increasing influence from China on US or EU companies prompted many legislators to strengthen their FIR regimes. The development culminated in the COVID pandemic, when governments realized the vulnerability of their national health industries and supply chains.

In response to these developments, FIR has in many jurisdictions been expanded, e.g. in the US by the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA), in the UK by the National Security and Investment Act 2021 (NSIA) and in the EU by the introduction of an EU-wide foreign investment screening mechanism for the coordination of national foreign investment review screenings with the enactment of the EU FIR Screening Regulation in 2019[22], the further strengthening of which is envisaged in accordance with a legislative proposal published by the European Commission in January 2024.[23] While the EU FIR Screening Regulation in its

[19] Foreign Investment and National Security Act of 2007 (FINSA), available at: https://www.govinfo.gov/app/details/STATUTE-121/STATUTE-121-Pg246.

[20] National Security and Investment Act von 2021 (NSIA), available at: https://www.legislation.gov.uk/ukpga/2021/25/contents/enacted.

[21] See e.g., in Germany Article 4 (1) of the Foreign Trade Act (*Außenwirtschaftsgesetz – AWG*), available (in English) at: https://www.gesetze-im-internet.de/englisch_awg/index.html and Articles 55-62 Foreign Trade Ordinance (*Außenwirtschaftsverordnung – AWV*), available (in English) at: https://www.gesetze-im-internet.de/englisch_awv/index.html. See an overview of all national FIR screening mechanisms, last updated 28 February 2024, at Investment screening - European Commission (europa.eu).

[22] Regulation (EU) 2019/452 of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union (L 423/1), available at: Regulation - 2019/452 - EN - EUR-Lex (europa.eu).

[23] See press release of the European Commission of 24 January 2024 "Commission proposes new initiatives to strengthen economic security", available at: New initiatives to strengthen economic security (europa.eu) with further references and communication of the European Commission of 24 January 2024 "Advancing European economic security: an introduction to five new initiatives" (COM(2024) 22 final), available at: https://commission.europa.eu/document/8b5910fe-10ea-4645-8b14-162ff72ea049_en.

current form essentially provides for a mere notice-and-comment procedure at EU level, leaving foreign investment review screenings largely to the discretion of the EU member states, the most recent European Commission proposal provides for an obligation for EU member states to introduce FIR screening mechanisms where FIR screenings are currently not in place, as well as specific procedural and substantive criteria for national review mechanisms. The European Commission requires the mandatory introduction of closing prohibitions and the possibility of a review of closed transactions under national law as well as the mandatory screening of M&A transactions related to targets in specific business sectors.

In recent years, there has been a global trend to first expand FIR to critical infrastructure (military and civilian) and then, arguably by a stretch of the concept of national security, to a broad range of industries also deemed sensitive from a national security standpoint, including e.g. companies in the sectors of energy, food supply, financial services, healthcare and telecommunication, and more recently biotechnology, artificial intelligence and robotics. The definition of what constitutes critical infrastructure or otherwise sensitive companies or assets from a national security perspective varies from jurisdiction to jurisdiction and is often based on references to complex catalogues of technologies and products. The determination whether a target business falls under these definitions requires a detailed analysis of technologies and products, sometimes going down to the level of the concentration of certain ingredients or the method of processing certain raw materials.

Many jurisdictions have lowered the thresholds of ownership that trigger FIR. While in previous years FIR was triggered by the acquisition of a majority stake only, in many jurisdictions today FIR starts already with the acquisition of 25%, 10% or, in extreme cases (e.g., investments in cybersecurity companies in Italy) as low as 3%. In most jurisdictions and sectors in the EU, FIR is required only for acquisitions by non-EU acquirers. In certain jurisdictions and sectors, however, e.g., in certain sensitive sectors in France or Italy, in the defense sector in most jurisdictions or very generally in the UK, even an acquisition by an EU or national acquirer can require FIR clearance.

In the case of private equity most FIR regimes look through the investment structures to the investors in the funds. The existence of foreign investors, even passive investors, and in particular foreign sovereign wealth funds can trigger FIR clearance requirements.

FIR is not necessarily limited to transactions providing for a change of control. An increasing number of jurisdictions, e.g., Canada and the UK, require or consider requiriring FIR clearance also for certain group-internal transactions. Furthermore, certain jurisdictions, e.g., the US and the EU, may extend FIR to outbound investments of national companies in critical foreign jurisdictions.[24]

Tightening of FIR enforcement

In addition to the expansion of the scope, many jurisdictions have tightened the legal mechanisms for enforcement of FIR. Until recently, the FIR regime in most jurisdictions provided for a post-acquisition review only, with the possibility of the parties to seek pre-acquisition clearance through a voluntary filing. In recent years, this has been replaced in many jurisdictions, at least for certain particularly critical areas, by a mandatory filing requirement and a FIR clearance pre-acquisition. Consummation of some types of transactions prior to clearance is prohibited and, similar to merger control, sanctioned by significant fines.

[24] See for the US the Executive Order of President Biden of 9 August 2023 "Executive Order on Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern", available at: Executive Order on Addressing United States Investments in Certain National Security Technologies and Products in Countries of Concern | The White House and for the EU the consultation paper of the European Commission of 24 January 2024 "Monitoring and risk assessment of outbound investment", available at: Monitoring and risk assessment of outbound investment - European Commission (europa.eu).

Authorities are to an increasing extent permitted and encouraged to search for and call in unnotified transactions. Those transactions can be unwound, and the parties be sanctioned with fines. This has recently led to a steep increase in FIR filings. According to a report of the EU, in the member states in 2022 about 1,444 FIR filings were made.[25]

Particular challenges of FIR in M&A transactions

The challenges raised by FIR for international M&A transactions are similar to those raised by merger control but can under certain aspects be even more difficult to overcome:

No one-stop shopping but EU-wide screening process

For FIR in the EU, there is not, like for merger control, a "one-stop shopping" mechanism, i.e., there is no EU-wide filing and clearance process. Instead, FIR filings must be made in every one of the 27 EU jurisdiction where the local requirements for FIR are met.

Since 2020 there is a coordination mechanism between the national FIR authorities in the EU and the European Commission under the EU FIR Regulation in place.[26] The coordination mechanism, however, does not make the filing easier for the transaction parties. In its current form, the EU coordination mechanism essentially provides for a notice-and-comment procedure with respect to the foreign investment review screenings conducted by the EU member state in question. The national FIR authorities inform each other and the European Commission of the FIR screenings initiated and may comment on the screenings of the other EU member states from the perspective of public order and security concerns of their country. This will essentially remain the same, even if the European Commission proposal for amendment of the EU FIR Screening Regulation[27] is adopted. The European Commission proposal, however, more clearly sets out which national FIR screenings conducted by the respective EU member state will have to be notified to the European Commission and which will not.

The coordination mechanism, even if it is amended in accordance with the European Commission proposal, shall assure that foreign investments in an EU member state with a potential impact on the public order and security of another EU member state will be brought to the attention of that other EU member state by the EU member state reviewing the investment, whether formally or informally. The European Commission will, along with the other EU member states, continue to be able to comment on the transaction that an EU member state has decided to review, but will still not have the authority to decide on restrictions.

The exchange of information between the EU member state authorities competent for the conduct of foreign investment reviews can in any case create significant uncertainty for the transaction parties. If the parties, e.g., decide to make a FIR filing only in certain EU jurisdictions with very excessive filing requirements, they might quickly receive inquiries from other national FIR authorities on why no filing had been made there.

No established FIR practice

Since tighter FIR is a relatively new instrument, the handling of FIR by the authorities in practice suffers from many inefficiencies. Compared to merger control, which can build on several decades of an established and well-published enforcement practice and sophisticated academic scrutiny, FIR is not as well established. Many jurisdictions are in the process of adjusting the staffing and resources of the

[25] See European Commission "Third Annual Report on the screening of foreign direct investments into the Union" of 19 October 2023 (COM(2023) 590 final), available at: https://circabc.europa.eu/ui/group/be8b568f-73f3-409c-b4a4-30acfcec5283/library/dca97cba-7d18-49f0-ad89-90a958191d9b/details.

[26] Regulation (EU) 2019/452 of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, availabnle at: https://eur-lex.europa.eu/eli/reg/2019/452/oj.

[27] See Fn. 23.

authorities to the increasing number of cases triggered by the expansion of their FIR regimes. Many national FIR authorities are still developing a principled and casuistic approach to the review of foreign investment and an established FIR practice is yet to emerge, often in the absence of clear guidelines and policies. The policy considerations underlying FIR and the interpretation of key terms are often unclear. Decisions are usually not published. All of this makes the length of the procedures, the scope of information to be provided and the outcome often unpredictable.

Additional efforts and delay of process

For most M&A transactions, the challenge created by FIR is not so much the risk of an actual prohibition. So far, the number of outright prohibitions is low.[28] The challenge lies more in the delay of the transaction process, resulting from the time and effort it takes to establish FIR filing requirements, to prepare the FIR filings and to undergo the length of the clearance procedures. The time and effort are a particular nuisance for the parties if it turns out in the end, as is often the case, that the transaction is actually far away from raising concerns for the national security.

[28] In the EU, in 2002 only 1% of screened transactions were blocked in 4% were abandoned; see report of the European Commission referred to in Fn. 25.

5

Foreign Subsidies Regulation (FSR)

A third and new regulatory hurdle, applicable since 12 October 2023 to large M&A transactions with target companies in the EU, has recently been introduced by the adoption of the Foreign Subsidies Regulation (FSR) of the EU.[29] The FSR is part of the general regime in the EU to control and restrict state subsidies. The purpose of the FSR is to create a "level playing field" for competition in the EU and preventing a sell-out of EU companies to heavily subsidized non-EU purchasers. The concern regarding heavily subsidized purchasers arose originally with a view to state-owned Chinese acquirers, but extended recently to acquirers from oil-rich Middle Eastern jurisdictions and, most recently, acquirors from the US, in light of the large subsidization programs implemented by the Biden administration, e.g., under the recently adopted US Inflation Reduction Act.

Process of FSR clearance

The FSR implements a clearance requirement for transactions very similar to EU merger control. The direct or indirect acquisition of an EU-headquartered company with group-wide sales in the EU in excess of EUR 500 million requires clearance by the European Commission if the target group and acquirer group have received in the three years prior to the acquisition aggregated foreign subsidies exceeding EUR 50 million. If these thresholds are met, the acquisition must be notified to, and cleared by, the European Commission. Consummation prior to clearance is prohibited and sanctioned by a fine that can reach up to 10% of the parties' combined annual turnover. The European Commission has the power to call acquisitions for review even below the thresholds if it suspects that foreign subsidies distort competition in the EU. If the European Commission calls a transaction, consummation is prohibited until clearance.

The process for the review is very similar to the merger control process, with a Phase I of 25 working days, potentially followed by a Phase II of 90, extendable to 125, working days. Prior to the formal filing, informal pre-clearance with the European Commission is suggested.

The European Commission will review whether foreign subsidies distort competition in the EU and the adverse effects of such distortion are not outweighed by positive effects of the subsidies.

[29] Regulation (EU) 2022/2560 of 14 December 2022 on foreign subsidies distorting the internal market (L 330/1), available at: Regulation - 2022/2560 - EN - EUR-Lex (europa.eu).

Challenges of the FSR for M&A transactions

Since the FSR is very new, there is no experience yet how it will be implemented and which effects it will have on M&A transactions. The European Commission has adopted Implementing Regulations[30] and answered a number of questions in the form of FAQs on the Commission's website, but many questions remain open. A number of points will probably pose challenges for M&A transactions:

Unclear definition of foreign subsidies

The definition of foreign subsidies in the FSR is very broad. It includes not only grants and loans, but also tax benefits and even the delivery of goods, services or payments in commercial transactions with public entities. For the calculation of the foreign subsidies threshold, commercial transactions count, regardless of whether they involve an element of subsidization (e.g., overstated prices for the purchase of goods or services, understated prices for the supply of utilities etc.). Companies with significant business with public entities will thus inevitably meet the threshold.

Broad scope of information to be provided

The information to be provided by the transaction parties to the European Commission is very broad. Information must be provided on a form prescribed in the Introductory Guidelines to the FSR, which is similar to the Form CO requested for merger filings. The parties must provide details of the transaction, their business strategy, the purchaser's plans for the target business and all foreign subsidies received through the last three years. In an auction process, the purchaser must "to the extent known" name any other bidders.

Unclear standards for the review and remedies

The Commission must assess whether a foreign subsidy distorts the internal market. The FSR lists certain indicators and examples to be considered by the Commission, but leaves the interpretation of distortion largely unclear. Subsidies which over a period of 3 years do not exceed EUR 4 million in total or EUR 200,000 for a certain foreign country will not be considered to distort the internal market. For subsidies in excess of these amounts, a distortion of the market could be found.

It is not yet clear whether and to what extent the subsidies or distortion of competition must relate to the acquisition or can be of a general nature.

If a distortion is found, the Commission may balance it against the positive effects of the subsidy and impose redressive measures to remedy the distortion. Also, as with merger control or FIR, the parties can offer remedy commitments. Remedies to prevent a distortion of the market will likely be behavioral rather than divestment remedies, including, e.g., onshoring requirements, investment obligations or site or job guarantees.

[30] Implementing Regulation (EU) 2023/1441 of 10 July 2023 on detailed arrangements for the conduct of proceedings by the Commission pursuant to Regulation (EU) 2022/2560 of the European Parliament and of the Council on foreign subsidies distorting the internal market (L 177/1), available at: [Implementing regulation - 2023/1441 - EN - EUR-Lex (europa.eu)](europa.eu).

6

Conclusions for successful M&A transactions

In order to navigate the new regulatory challenges, M&A transaction parties need to adapt their deal strategies and transaction processes. This applies to the sell-side as well as the buy-side.

Conclusions on the sell-side

Careful bidder selection

In order to understand and evaluate the regulatory challenges of the bidders, the seller in an auction process needs to push the bidders to do their regulatory homework up front so that the seller can as accurately as possible assess the regulatory risk.

Traditionally, if the seller has been concerned that a certain bidder might face serious regulatory challenges, the seller's decision has often been to exclude the bidder from the sale process. In a market with an abundance of bidder interest, this might be a reasonable decision, based on the expectation of a sufficient number of equivalent bidders with no or lesser regulatory challenges. In a tighter market environment, sellers might, however, no longer have the luxury of a large universe of 'suitable' bidders. Especially, when focusing on strategic bidders, the seller might receive only a limited number of attractive and credible bids. The bidders who offer the highest price will often be bidders with regulatory challenges. In such a situation, responding to the regulatory challenges by excluding such bidders from the sale process might not be a wise decision. Instead, the seller should work with the bidders and their counsels to understand the regulatory challenges in detail and identify ways to overcome them.

Hell-or-high water commitments and reverse break fees alone may not be sufficient to protect the seller

While a seller should not automatically rule out a bidder because of regulatory challenges, a smart seller should also not treat the regulatory matters as essentially an issue for the bidder to deal with. In recent years, sellers in a strong negotiation position have been able to shift the regulatory risk to the purchaser through "hell-or-high-water" obligations[31] and a material reverse break fee and/or daily ticker fee for the delay of closing beyond an agreed date.[32] Hell-or-high-water provisions and break or ticker fees, do not, however, provide a seller with deal certainty or a guarantee of overcoming regulatory challenges.

A hell-or-high-water obligation reads nicely in the SPA but is difficult to enforce. Obtaining, in an international transaction, numerous regulatory clearances is a complex process that requires the dedicated collaboration of all parties involved. If clearances are not obtained and the transaction fails, it will often be difficult for the seller to point to the

[31] Meaning the bidder must obtain regulatory clearances "come hell or high water"!
[32] See e.g., the break fee of US 1bn which the insurance broker Aon had to pay after its USD 30bn merger with Willis Towers Watson failed to secure merger clearance in the US and the break fee in the same amount that the software group Adobe had to pay after its USD 20bn acquisition of Figma was rejected by the European Commission.

purchaser as the sole cause of the failure. Accusations of responsibility will meet counteraccusations of co-responsibility. Depending on the details of the hell-or-high-water obligation, the seller might have to prove that conduct of the buyer has caused the failure to obtain clearances and/or that conduct of the seller did not adversely impact the buyer's ability to obtain clearances. The outcome of the dispute might, thus, be hard to predict.

A reverse break fee or ticker fee is, depending on the terms of the SPA, easier to enforce but rarely will fully compensate the seller for the loss of value resulting from the failure of the transaction. A reasonable seller will therefore think hard before letting the transaction fail and resorting to the break fee.

Regulatory analysis and preparation by the seller

Therefore, if a transaction is likely to have regulatory risk, even if the risk of regulatory clearance has been formally shifted to the purchaser in the SPA, the seller is well advised to conduct its own analysis of potential regulatory challenges. The analysis should include anticipating and crafting any remedies, in particular divestments, which could be required from the purchaser. If a divestment remedy demand is likely and will involve a split of central business functions of the target group or a carve-out, the seller should prepare the split or carve-out in advance of the sale. Ideally, the seller might even implement the carve-out before the deal, e.g., by separating the potential divestment business from the target business and splitting the central business functions so that the divestment business can function on a stand-alone basis. However, in practice, this might often not be possible because the sale is not yet sufficiently certain, the time before the sale is short or the carve-out creates too much disruption for the business.

Incentives for sell-side management

The management of the target, including the divestment business, will be key to transaction success. Being mindful of the significant extra work which the management needs to carry out in a case involving regulatory complexity for the regulatory processes, carve-out and divestment, the seller should think of a reasonable incentivization of the management. A traditional transaction bonus, depending mainly on the proceeds of the transaction, is too unspecific. The bonus should rather be tied to specific milestones concerning the regulatory process, carve-out and divestment.

Conclusions on the buy-side

Early identification of regulatory challenges

On the buy-side, a very thorough identification of regulatory requirements and planning of the regulatory processes early in the transaction process is key. This may also require the inclusion in the SPA of conditions precedent relating to voluntary merger regimes (e.g., the UK), and filing requirements under FIR and FSR regimes if applicable. In order to avoid unnecessary costs, purchasers sometimes delay the in-depth regulatory analysis until late in the transaction process, when the signing of an SPA is at hand. In transactions with suspected regulatory challenges this is too late. The purchaser must understand as early in the process as possible any requirements for carve-out and divestment and assess the impact on the business plan and value of the target business and on the provisions, it will need in the SPA in order to successfully comply with its conditions precedent to obtain necessary approvals.

Support obligations in the SPA

In the SPA, the purchaser should receive from the seller and the target group, even in a hell-or-high-water context, all support necessary to obtain the regulatory clearances. If the purchaser will likely have to divest parts of the target business, the support obligations of the seller and the target should extend to the preparation and implementation of the divestment. Those support obligations should be stated in the SPA as specifically as possible.

Access to information about the target business

In order to prepare, let alone implement, a remedy divestment, the purchaser, as divestment seller, needs broad access to the target business. This is particularly important if the divestment requires a carve-out or reverse carve-out. Purchaser demands for information will, however, face confidentiality concerns of the seller as well as legal concerns regarding gun-jumping with respect to the main transaction. In order to overcome these concerns, a thoughtful information-exchange process should be established that differentiates between various levels of sensitivity of information and groups of information recipients, including clean teams of the parties with only external advisors and/or non-market facing staff of the parties. These information-exchange processes must be set out in clean team agreements and be administered with robust access control.

Hold-separate

In critical cases, the regulatory authorities might go a step further and demand, in addition to restrictions on the flow of information, that a separation of the divestment business from the remaining target business ("hold-separate") during the preparation of the divestment may be needed. This makes the divestment process "top-heavy", with the carve-out or reverse carve-out coming at the beginning rather than at the end of the process.

The implementation of a "top-heavy" separation is particularly challenging with respect to the IT of the target business. In most corporate groups, IT is integrated, and the separation of the divestment business's IT involves a significant and lengthy process. Such IT separation is often the critical path for the planning of the divestment overall.

Hell-or-high-water and reverse break fee

In a transaction with a strong seller position, the purchaser will likely have to accept hell-or-high-water obligations and/or a reverse break fee or cash ticker. The respective clauses should take into account, however, the support obligations of the seller and clearly delineate the responsibilities of the seller and the purchaser.

Back-to-back transactions with a divestment buyer

If it is likely that the purchaser will have to divest parts of the target business, it could make sense for the purchaser to try, ahead of the sale process, to team up with a third party as the proposed buyer of the divestment business and have a back-to-back transaction. The third party could be a strategic buyer or a financial buyer (provided that this does not raise prima facie competition concerns). If the purchaser has teamed up with a divestment buyer, the purchaser is in a better position to meet requirements of the merger authorities for an upfront buyer or to subscribe to a fix-it-first divestment scenario.

An early teaming-up would also potentially make the purchaser more attractive to the seller, tie the divestment buyer into more price certainty and avoid a ‘fire sale’ of the divestment business, enable a simultaneous due diligence exercise and split of the due diligence costs between the purchaser and the divestment buyer and, for the purchaser, alleviate the burden of financing the whole purchase price. If the parties succeed in structuring the main transaction and divestment with simultaneous or consecutive closings, the divestment buyer might be able to pay the purchase price for the divestment business directly to the seller on account of the purchase price obligation of the purchaser in the main transaction, so that the purchaser only has to finance the difference between the main purchase price and divestment purchase price.

Purchase price for divestment based on closing accounts rather than locked box

In the SPA for the divestment, the purchase price will likely need to be determined by closing accounts rather than a locked box mechanism. This is because, at the time when such purchase price is agreed upon (which is usually prior to the closing of the main transaction), the purchaser, as divestment seller, does not yet have the detailed knowledge of the financial situation of the divestment business necessary to comfortably determine a fixed locked-box purchase price. The divestment seller runs the risk of calculating the purchase price incorrectly. Closing accounting gives the divestment seller the opportunity of a true-up after the closing of the main transaction and divestment, at a time when the divestment seller is in possession of the relevant information.

Conclusions for both parties

FSR-readiness

Companies planning to pursue, whether as seller or purchaser, transactions involving targets with EU-wide turnover in excess of EUR 500 million should prepare well in advance for an expected FSR review. A seller will likely have to deal with an FSR review if the purchaser and/or such a target has received non-EU subsidies in excess of EUR 50 million. Given the broad definition of subsidies, including tax benefits and commercial transactions with public entities, the EUR 50 million threshold can easily be reached.

A purchaser will face an FSR review if the purchaser and/or the target itself has received non-EU subsidies in excess of EUR 50 million. Again, this will likely be an issue primarily for non-EU purchasers, but also for EU purchasers if their own business or the target business is foreign subsidies heavy as, e.g., in the natural resources, energy, semiconductor, healthcare or even the automotive industry.

In order for a purchaser or target to be FSR-ready, it is important to screen the entire business for foreign subsidies received during the last three years and document these subsidies. Again, given the broad definition of subsidies, this could be a burdensome task. In order to ease this burden for future transactions, a system for cataloguing foreign subsidies should be implemented.

In due diligence, whether of the purchaser or seller, compliance with FSR requirements and correctness and completeness of FSR-relevant information should be a new and separate topic.

SPA provisions for a post-closing review

In view of the expanded possibilities for the regulatory authorities to review transactions post-closing, and the publicly stated intention of many authorities to pursue post-closing reviews, the parties should, at least in potentially critical cases, provide for the possibility of a post-closing review in the SPA. The SPA provisions should give the parties the right to comply with orders of the authorities, set up a process to collaborate and mechanisms for an unwinding and separation, if any, and allocate the risks and burdens, including, where appropriate, an adjustment of the purchase price.

Assumption of global process coordination by the parties and their legal advisors

As explained above, if an international transaction requires multiple regulatory clearances, whether merger control, FIR or FSR, a key challenge is to design, agree upon and implement a global divestment package with multiple authorities should this be necessary. In the absence of established formal processes around international collaboration among regulatory authorities on timing, the task of coordinating the multiple national clearance processes and designing a remedy package that meets the requirements of all authorities must be taken up by the parties and their legal advisors. It is their role to determine a divestment package, process and timeline that satisfies all requirements.

In order for the parties to assume, in collaboration with multiple authorities, the global coordination of the timeline for regulatory clearances and divestments, the parties need legal advisors who have the necessary resources and experience to conduct and coordinate processes with multiple authorities. This requires a well-connected team of legal experts in all relevant jurisdictions, strong project management capabilities and an excellent rapport with the relevant authorities.

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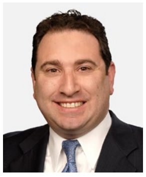

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