ALERT MEMORANDUM

Industrial Strategy Post-Brexit: The UK's Power To Block Mergers On Public Interest Grounds

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On 11 July, Theresa May, the UK's new Prime Minister, gave a speech in which she called for "a proper industrial strategy to get the whole economy firing"[1]. Mrs May noted US pharmaceuticals company Pfizer's attempt to acquire AstraZeneca two years ago, a company she referred to as "one of the jewels in [Britain's] crown". Mrs May said the UK's industrial strategy should be capable of "stepping in" to defend sectors such as pharmaceuticals that are important to the economy.

Mrs May's statements should be considered in the context of the UK's relationship with the EU. The UK Government may today intervene on public interest grounds in merger investigations carried out by the UK Competition and Markets Authority (CMA). Lord Mandelson used these powers as Secretary of State to allow Lloyds TSB to acquire HBOS in spite of the Office of Fair Trading's (OFT's) recommendation that the transaction be referred to the Competition Commission (CC)[2] for an in-depth review.

These powers to intervene may become more meaningful in a post-Brexit world, should the UK no longer be subject to the EU Merger Regulation (EUMR)[3]. Until now, the UK Government's power to intervene in mergers that are subject to review by the EU Commission has been strictly limited by EU law. Depending on the UK's status after it withdraws from the EU, it could be in a position to block mergers on public interest grounds that the EU Commission has approved from a competition law perspective.

In this memorandum, we examine the UK Government's current powers to intervene in mergers under the Enterprise Act 2002 (EA 2002) and the way in which the EUMR restricts these powers. We then consider other legislative provisions (including those applicable to regulated businesses) that would allow interventions on non-competition grounds. Finally, we assess how Brexit may allow the UK Government to use these powers in a wider range of mergers, including those that currently fall under the exclusive jurisdiction of the EU Commission.

[1] *See* http://www.theresa2016.co.uk/we_can_make_britain_a_country_that_works_for_everyone
[2] The OFT and CC were replaced by the CMA on April 1, 2014.
[3] Council Regulation (EC) No 139/2004 of 20 January 2004.

Powers to intervene in mergers under the EA 2002.

One of the objectives of the Competition Act 1998 (CA 1998) and EA 2002 was to remove politicians from the enforcement of competition law, leaving decisions to independent technical experts. The UK Government has no role in CA 1998 cases (including investigations under Article 101 and 102 of the Treaty on the Functioning of the European Union), director disqualification orders or criminal cartel prosecutions. It nevertheless retained a residual power in mergers and markets cases, exercised by the Secretary of State.

Under the EA 2002, the Secretary of State has the power to intervene in mergers in three situations: (a) public interest cases; (b) special public interest cases; and (c) certain mergers reviewable by the European Commission under the EUMR ("EU mergers").

Public Interest cases

The CMA has a duty to refer a merger for an in-depth "phase 2" investigation where it believes that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition in the UK. Following a reference, a CMA Inquiry Group conducts a more detailed analysis to decide whether to prohibit a merger, or to clear it (with or without remedies).

Before the CMA makes a decision to refer a merger for a phase 2 investigation, the Secretary of State may issue a public interest intervention notice (PIIN) if he believes that at least one public interest consideration is relevant to the assessment of the merger. Public interest considerations are defined in the EA 2002 as: national security, plurality of the media, and stability of the UK financial system. The Secretary of State has the power to add other considerations by making an order that must be approved by Parliament.

Where a PIIN has been issued, the Secretary of State acts as decision maker, and decides whether or not to make a phase 2 reference. If a case has been referred in this way, the CMA must report to the Secretary of State on whether the merger is expected to operate against the public interest as well as the merger's impact on competition. The Secretary of State then has the discretion to make an "adverse public interest finding" and to use enforcement powers to remedy the adverse effect, including the power to prohibit the merger. To date, three PIINs have been issued under this provision.

Public Interest Intervention Notices

BSkyB/ITV. The first PIIN was issued on February 2007 in relation to BSkyB's acquisition of a 17.9% stake in ITV. The Secretary of State referred the transaction to the CC on the grounds that it might be expected to result in a substantial lessening of competition *and* also that a public interest consideration (media plurality) was relevant to the consideration of the merger. Following the CC's final report, the Secretary of State decided that the transaction did not have an adverse effect on media plurality, but that BSkyB's stake in ITV should be reduced to less than 7.5% on competition grounds.

Lloyds TSB/HBOS. The second PIIN was issued on September 2008 in relation to Lloyds TSB's attempted acquisition of HBOS. The OFT found that there was a realistic prospect that the merger would result in a substantial lessening of competition and advised that it should be referred to the CC. At the time of the merger, the only specified public interest considerations under the EA 2002 were national security and newspaper and media public interest considerations. By order, the Secretary of State added "the interest of maintaining the stability of the UK financial system" as a new public interest consideration and, on this ground, decided not to make a reference to the CC.

Global Radio/Guardian Media Group. The most recent PIIN was issued in August 2012 relating to the proposed acquisition by Global Radio Holdings of Guardian Media Group's radio stations. The PIIN, which was based on media plurality, was ultimately withdrawn, and the transaction was referred to the CC on competition grounds alone.

Special Public Interest cases

Special public interest cases concern an exceptional category of mergers that do not meet the UK's merger jurisdiction tests,[4] but which may still be investigated on public interest grounds (but not competition grounds). Two types of mergers may be considered under this provision: the first is mergers involving certain "government contractors" holding confidential information relating to defence; the second is certain mergers in the newspaper and broadcasting sectors.

In special public interest cases, the Secretary of State may serve a "special intervention notice" on the CMA, requiring it to investigate and report on specified public interest considerations.[5] The Secretary of State may then make a reference to the CMA for a phase 2 investigation and report into the specified public interest considerations. Following the CMA's phase 2 report, the Secretary of State has the power to take enforcement action.

There have only been two cases under these provisions. The first special public interest intervention notice was issued in August 2005 in relation to Lockheed Martin's acquisition of INSYS Group, a UK-based diversifier integrator of military systems. The second was issued in May 2009 in relation to Atlas Elektronik's purchase of QinetiQ's underwater systems business. In both cases, the Secretary of State ultimately accepted undertakings in lieu of a reference to the CC.

EU mergers

Under the EUMR, the EU Commission has exclusive jurisdiction to review any merger that has an EU dimension.[6] This "one-stop merger control" principle means that individual Member States generally cannot investigate or intervene in mergers with an EU dimension and must abide by the EU Commission's decision to clear or block a deal.

There are some limited exceptions under which a Member State can intervene in mergers with an EU dimension: under Article 21(4) of the EUMR, Member States may take "appropriate measures" to protect certain legitimate interests, namely, public security, plurality of the media, and prudential rules.[7] Any other public interests must be approved by the EU Commission on a case-by-case basis.

Member States can exercise their residual power under Article 21(4) as of right, provided any measures they take to protect their legitimate interests fall within the stated exceptions, and can apply to the EU Commission for permission to intervene on other public interest grounds, which must in any event be compatible with the principles and other provisions of EU law.[8] EU Commission decisions allowing a Member State to proceed on the basis of other public interest grounds are rare.[9] In *News Corp/BSkyB*, for example, the EU Commission cleared the merger but acknowledged the right of the UK to consider its potential effects on the plurality of the media.[10] Likewise, in *Thomson-CSF/Racal*, the UK investigated the public security aspects of the merger under the domestic merger provisions.[11]

In some cases, the EU Commission has prohibited interventions for failure to show a legitimate interest. For example, in *Secil/Holderbank/Cimpor*, the EU Commission received a notification of Secil's and Holderbank's intention to acquire Cimpor, a Portuguese cement company undergoing privatization. Following the EU notification, the Portuguese Finance Minister refused to authorize the acquisition, essentially on the grounds that the acquisition was contrary to Portuguese economic policy. The EU Commission found that none of the three legitimate interests set out in Article 21 EUMR

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[4] The EA 2002 applies to completed or anticipated mergers where the UK turnover associated with the enterprise which is being acquired exceeds £70 million (the "turnover test"), or where as a result of the merger, a share of 25% or more in the supply or consumption of goods or services of the same description is created or enhanced in the UK or substantial part of the UK (the "share of supply test").

[5] In media cases, Ofcom must also provide advice and recommendations to the CMA. See EA 2002, s. 61A.

[6] Whether or not a merger has an EU dimension is determined by reference to the turnover of the undertakings concerned in a transaction. *See* Article 1 of EUMR.

[7] *See* Article 21(4) EUMR.

[8] *See, e.g.*, S.I. 200311 592.

[9] As of June 2016, the EU Commission has only granted permission in eight occasions. *See* http://ec.europa.eu/competition/mergers/statistics.pdf.

[10] Case M 5932, decision of 21 December 2010.

[11] Commission Press release IP/00/628.

applied in this case and required the Portuguese Government to withdraw its opposition to the acquisition. [12] The EU Commission reached similar conclusions in *UniCredito/HVB*,[13] *E.ON/Endesa*,[14] and, *Abertis/Autostrade*,[15] where it considered that Member States violated Article 21 of the EUMR as a result of measures they took to oppose mergers that the EU Commission had already cleared.

The EU Commission is widely expected to continue applying Article 21 strictly; it has made declarations to the European Parliament that it will look with concern at any attempts by national governments to interfere in the process of cross-border corporate restructuring.[16] In its contribution to an OECD policy roundtable on competition policy, the Commission emphasized that the creation of "national champions" cannot be invoked as a justification to set aside antitrust rules.[17] And, more recently, former Commissioner Joaquin Almunia expressed his opposition to national protectionist measures.[18] The scope for Member States to intervene in mergers with an EU dimension is therefore likely to remain limited to the grounds set out under Article 21 of the EUMR.

Other powers to intervene in UK mergers

In addition to the powers under the EA 2002 to intervene in mergers on public interest grounds, there are additional legislative provisions that allow the UK Government to intervene:

- Under s. 13 of the Industry Act 1975, the Secretary of State can issue an order prohibiting a non-UK person from gaining control of manufacturing undertakings deemed to be of special importance to the UK.
- Under the Water Industry Act 1991, the CMA may prohibit a merger if it is likely to prejudice Ofwat's ability to make comparisons for the purpose of carrying out its statutory functions (such as setting price controls on regulated water enterprises and other regulatory functions).[19]

The UK Government has never used the first of these provisions and, in the case of a merger with an EU dimension, it would have to notify any such prohibition to the EU Commission under Article 21(4) of the EUMR (which would likely be rejected). As for the second provision, the EU Commission has recognised the UK's legitimate interest under Article 21 in applying the special water regime to ensure that Ofwat can continue to exercise its regulatory functions in a satisfactory manner.[20]

Licensing regime for regulated businesses

The UK Government has the power to grant or revoke licenses for acquirers in regulated sectors. For example:

- In relation to the acquisition of broadcasting licenses, Ofcom must be satisfied that any

[12] The Parties withdrew the notification in this case before the Commission reached a decision: Case M 2054. *See also*, http://ec.europa.eu/competition/publications/cpn/2005_1_19.pdf.
[13] Case M 3894, decision of 18 October 2005
[14] Case M 4110, decision of 25 April 2006
[15] *See* Commission Press Release IP/06/1418, 18 October 2006.
[16] *See* Neelie Kroes "Introductory remarks on Mergers in the Internal Market", 15 March 2006, at http://europa.eu/rapid/press-release_SPEECH-06-172_en.htm?locale=en ("…the process of cross-border corporate restructuring enhances the competitiveness of European business by equipping it to succeed in global markets. Any interference in this process by national governments which is not justified by legitimate interest as foreseen in the Treaties, secondary legislation or jurisprudence, would risk to be seriously damaging for the prospects for Europe to benefit from the opportunities presented by market integration and globalisation").
[17] *See*, OECD Policy Roundtables, "Competition Policy, Industrial Policy, and National Champions", 2009, at pages 143–147.
[18] *See* Joaquin Almunia, "Some highlights from EU Competition enforcement", 19 September 2014, at http://europa.eu/rapid/press-release_SPEECH-14-608_en.htm ("As a necessary condition to return to a sustainable growth path, we need to come together and rekindle our confidence in the Single Market. Tearing down the remaining barriers, deepening the internal market in growth-promising sectors, and resisting protectionism are the first orders of business.").
[19] *See* sections 32 and 33A of the Water Industry Act 1991 (as amended by the Water Act 2014).
[20] *See* Case M.567, Lyonnaise des Eaux/Northumbrian Water, Commission decision of 21 December 1995. *See also* CMA Water and Sewerage Mergers Guidance. It may be that future cases would require a further request to the EU Commission under Article 21(4), given that previous requests were made under old legislation.

person holding a broadcasting license is, and remains, fit and proper to hold those licenses.[21]

- In the water sector, Ofwat must ensure that any prospective owner of a regulated water business has the probity and operational and financial capacity to assume that role.[22]
- In the financial services industry, any acquisition of control of a company regulated by either the Financial Conduct Authority (FCA) or the Prudential Regulation Authority (PRA) requires approval by the relevant regulator.[23] The FCA and/or PRA will assess the application by reference to several criteria, including the acquirer's reputation, financial soundness, and ability to comply with its prudential requirements.[24]
- In the energy sector, operators must obtain a license from Ofgem to carry out certain activities,[25] and the transfer of these licenses may be reviewable by Ofgem.[26]

Article 21 of the EUMR does not apply to these licensing regimes, as long as they are aimed at the conduct of acquirers in the market, rather than at the acquisition itself.[27] The EU Commission could prohibit any attempt by the UK Government to expand the reach of these licensing regimes in a way that interferes with EU mergers.

The UK's powers to intervene in mergers post-Brexit

The UK's ability to shape and implement its own industrial strategy after leaving the EU will depend on the form of any agreement reached with the EU. If, for example, the UK remains in the EEA, it will likely remain subject to the EUMR. Otherwise, the UK may have to comply with some EU laws but not others, and it is then possible that the UK would no longer be subject to the EUMR.

If the UK is not subject to the EUMR post-Brexit, this could affect mergers with an EU dimension, as the UK would be able to review such mergers in parallel with the EU Commission to take account of public interest criteria in assessing such mergers. The UK has historically adopted a non-interventionist approach to mergers. Even before the repeal of the Fair Trading Act 1973 (which contained a broader public interest test for assessing mergers) and its replacement with the EA 2002, most merger decisions focused on competition issues.[28]

The political mood has, however, changed in recent years. In Spring 2006, the potential takeover of Centrica, the gas supplier, by Gazprom of Russia prompted the Trade and Industry Secretary to seek advice on "gateways for ministerial intervention" in order to thwart any bid threatening energy security in the UK.[29] In January 2010, after Kraft acquired Cadbury and subsequently broke its pledge to keep a Cadbury factory in Somerset running, Vince Cable, then Treasury spokesman for the Liberal Democrats, called for the reintroduction of a wider public interest test for UK takeovers "to make sure that damaging takeovers do not take place".[30] In May 2014, Pfizer's bid for AstraZeneca led Ed Miliband, then Leader of the Opposition, to state that "there should be a stronger public interest test which encompasses cases such as these where strategic elements of our science base, with impacts well beyond the firm concerned, are involved."[31] Vince Cable, then Secretary of State, noted that the UK

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[21] *See* sections 3(3) and 86(4) of the Broadcasting Act 1990; sections 3(3) and 42(2) of the Broadcasting Act 1996; and section 235(3)(a) of the Communications Act 2003.

[22] *See* section 2(2A) Water Industry Act 1991.

[23] *See* section 178 Financial Services and Markets Act 2000, Chapter 11 of the FCA Supervision Manual, and Change in Control part of the PRA Rulebook.

[24] *See* section 186 Financial Services and Markets Act 2000.

[25] s.7 and 7A of the Gas Act and s.6 of the Electricity Act.

[26] Gas Act s8AA(6) and Electricity Act s7A(6)

[27] *See, e.g.,* Request dated 8 January from the United Kingdom for the recognition of a legitimate interest under article 21(3) Case N° IV/M.1346 – EdF/London Electricity.

[28] *See* Enterprise Bill, Library Research paper 02/21 4 April 2002, at page 39 ("For many years references to the Competition Commission have been made primarily on competition grounds…rather than the broader interests provided for in the statutory test").

[29] *See* Jean Eaglesham, "Centrica threat led to rethink on mergers", *Financial Times,* 17 April 2006.

[30] *See* Graeme Wearden, "Public interest test for takeovers should be reintroduced, says Vince Cable" *The Guardian,* 10 February 2010

[31] "Ed Miliband's letter to David Cameron on proposed Pfizer/AstraZeneca deal", Guardian, 4 May 2014.

would operate "within serious European legal constraints" in considering any extension to its public interest powers.[32] On 13 July 2014, some weeks following the collapse of Pfizer's bid, Mr Cable indicated that the Government was considering a change in the law to allow for wider interventions on public interest grounds.[33] Theresa May's recent remarks can, therefore, be seen in the context of a trend towards greater intervention, and may suggest that the UK could revert to a wider public interest test for assessing mergers.

While the focus of the recent political debate has been on takeovers of UK companies, the power to intervene in mergers on public interest grounds is not limited to those cases. Any transaction involving a business operating in the UK (including non-UK companies) could potentially fall within the scope of the public interest rules.

Conclusion

The UK Government has expressed an increasing willingness to intervene in mergers on public interest grounds. Currently, its ability to do so is limited by the EUMR. After Brexit, provided the UK is no longer subject to the EUMR, there may be considerable scope for widening intervention on grounds that are currently prohibited, such as prohibiting acquisitions by foreign companies, to protect national champions or reflect social considerations (such as unemployment).

Any such change would have important practical implications for merging parties, as it would give the UK an effective veto over EU mergers that are also subject to the UK's jurisdiction. Given that EU mergers often have a significant component of their revenue allocated to the UK, the impact of Brexit may be to compel merging parties to devote considerable time and effort to addressing any potential concerns that the UK Government might have.

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[32] HC Deb 6 May 2014 c23

[33] BBC One, The Andrew Marr Show – transcript for interview with Vince Cable, 13 July 2014 pp1-4 ("You need a last resort where the Government can intervene, can invoke the public interest under the existing legislation … we're going to proceed as a Coalition to deal with that … A lot of Conservatives would agree with it, but we haven't got to that point")