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Protectionism or Legitimate National Interest?

A European Perspective on the Review of Corporate Acquisitions by Foreign Purchasers

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I. INCREASING PROTECTIONISM IN EUROPE OR THE SAME OLD STORY?

In Europe, the question of whether there is, or should be, a role for national interest considerations in the review of corporate acquisitions by foreign purchasers has made headline news several times this year. In the Spring, Pfizer's proposed bid for AstraZeneca sparked concerns in the United Kingdom about whether the takeover of a U.K.-based company by a U.S.-based one would erode the U.K.'s national scientific research base and harm its standing not only in the United Kingdom but also globally.[2] Around the same time, concerns about General Electric's purchase of ALSTOM's energy business led the French government to expand its foreign investment approval rules to apply to an additional list of strategic sectors, and prompted an alternative proposal by Germany's Siemens to acquire the ALSTOM business and create a European champion.[3]

In addition to these specific examples, the continuing difficulties that the European economy is experiencing appear to be prompting a more general debate about broadening the basis for reviewing mergers beyond strict competition criteria in order to facilitate the creation of European champions better able to compete globally. For example, Germany's Chancellor Merkel and (then) French Industry Minister Montebourg have both publicly supported calls by some of the major European mobile telecoms companies to allow further consolidation in the sector.[4]

While this debate is currently taking place largely in political and media arenas, the existing supra-national framework of EU law that governs when and how EU Member States may intervene in mergers should not be overlooked. The overriding EU law principles establishing the European single market, and enforced by the European Commission, set limits

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[2] For example, the Secretary of State for Business,, Vince Cable, voiced concerns about the Pfizer bid, stating that the government would be "motivated by hard-headed considerations of the national interest" (*The Daily Telegraph,* May 6, 2014) and that one of the "options as the government would be to consider using [our] public interest test powers" (*Reuters,* 6 May 2014). Pfizer abandoned its bid for AstraZeneca in May 2014 following the rejection of its final offer of £55 per share by the board of AstraZeneca.

[3] GE responded by restructuring its offer to address the French government's concerns in order to receive its support.

[4] Chancellor Merkel advocated that a balance needed to be achieved between market power and competition so that European businesses "can score internationally" (*Financial Times*, May 8, 2014). Minister Montebourg spoke of the French Government's policy of "re-consolidating the sector" in France down to three operators (*Reuters,* April 9, 2014).

on the ability of EU Member State governments to intervene in cross-border deals. In particular, where transactions are subject to EU merger control rules, Member States have limited residual ability to intervene. For example, in relation to the proposed Pfizer/AstraZeneca merger, questions were raised over the legal scope for the U.K. government to intervene formally on public interest grounds in relation to the protection of domestic Research and Development ("R&D") and jobs.[5]

Several leaders of competition authorities in Europe have spoken out about the increased interest in economic protectionism. Outgoing European Competition Commissioner Joaquín Almunia has warned passionately against the dangers of intervention in antitrust enforcement, including mergers, on grounds other than competition throughout his five-year mandate.[6] Most recently, he has urged his successor, Competition Commissioner-designate, Margrethe Vestager, to "react strongly against the temptations of protectionism and of bad interventionism."[7] Vestager has been quick to take up the baton by publicly stating her desire to "resist any kind of politicizing of cases" and "keep protectionism at bay."[8] During her confirmation hearing before the European Parliament on October 2, 2014, she again rejected suggestions that competition laws should be relaxed in order to create European champions.[9]

Similar views have been expressed by national competition authorities' leaders. For example, Alex Chisholm, the Chief Executive of the new U.K. competition agency, the Competition and Markets Authority ("CMA"), has recently warned that "A re-politicisation by adding more exceptions to competitive-based merger controls, or introducing criteria in foreign investment control that have previously been abandoned in merger control by successive governments, could undermine business confidence and the credibility of any merger regime."[10]

There are many causes of this renewed focus on protectionism. The increased interconnection in the global economy, with greater cross-border trade flows and new sources of investment from Asia and the Middle East driving more cross-border M&A deals, is one factor. Within Europe (and elsewhere), with the still fragile state of many national economies following the financial crisis, there is also increased concern to safeguard jobs and foster national companies so that they are better able to compete internationally. Other factors include the apparently moribund state of the Doha round of World Trade Organization ("WTO") free trade

[5] Commentators observed that a U.K. government attempt to apply a public interest test under its domestic merger control regime to Pfizer's approach to AstraZeneca would run into serious difficulties with the European Commission (*Daily Telegraph*, May 17, 2014).

[6] For example, in 2010 Almunia said "we also have to make sure that Member States do not seek to impose unjustified conditions on European takeovers, so as to protect national champions." (SPEECH/10/149, at the Confindustria Conference, *Liberta e Benessere – l'Italia al Futuro*, April 9, 2010). And in 2011 he stated, "regardless of where the bidders come from, EU merger control must remain anchored to its own rules and purposes. It is crucial to keep our merger review immune from non-competition considerations." (SPEECH/11/166, co-presented by the IBA Antitrust Committee and the European Commission, *Merger Regulation in the EU after 20 years*, 10 March 2011.)

[7] *MLex*, (September 19, 2014).

[8] *MLex*, (September 29, 2014).

[9] *MLex*, (October 2, 2014).

[10] Speech by Alex Chisholm at the Fordham Competition Conference, September 11, 2014.

talks, a recent trend for U.S. companies to undertake so-called corporate tax inversion deals, and the current domestic political climates in a number of EU Member States.

In fact, the debate between economic patriots and free market advocates in Europe is not new. Previous deals have also given voice to desires to intervene in foreign takeovers by (i) making greater use of existing public interest exceptions to the largely competition-based system of merger control across the European Union, (ii) increasing the scope and use of foreign investment approval regulations, or (iii) changing public company takeover codes.

Examples include the takeover of the British confectionary company Cadbury by the U.S. food conglomerate Kraft in 2009,[11] and the 2006 takeover of the steel producer Arcelor, which had been created from companies based in Spain, France, and Luxembourg, by its India-originated competitor Mittal. While some EU Member States such as France have appeared consistently more inclined to protect their national industrial and commercial bases,[12] the approach in others is less predictable and appears to be partly dependent on the government of the day and the broader climate of international relations. For example, in 2006, then U.K. Prime Minister Tony Blair was reported to have ruled out trying to block a possible bid for the U.K. gas supplier Centrica by Russia's Gazprom.[13] We rather doubt whether the same approach would be taken by today's U.K. government.

These periodic calls for change beg the question of how the EU system works. This is explained in the following sections of this article. We first provide an overview of how the current EU merger control framework accommodates both competition and non-competition considerations and delineates the discretion of EU Member States to intervene within a framework of EU law enforced by the European Commission. We then outline how this framework is complemented by the European Commission's responsibility for overseeing EU Member States' adherence to the EU law principles of freedom of establishment and free movement of capital.

II. EU MERGER CONTROL RULE LIMITS ON EU MEMBER STATES INTERVENING AGAINST FOREIGN PURCHASERS

Under the EU Merger Regulation ("EUMR"), the European Commission generally has exclusive jurisdiction over transactions that meet prescribed turnover thresholds designed to catch the larger cross-border deals. The European Commission is empowered to review such transactions solely on a competition-based test—whether the transaction will "significantly impede effective competition" in the European Union. Within this framework, the European Commission routinely reviews and approves transactions involving non-EU purchasers on the

[11] After that bid, the United Kingdom changed its public company takeover code to strengthen the position of target companies by allowing them to request more information from bidders about their plans in relation to matters such as jobs, factories, and headquarters.

[12] Eight years before the recent so-called "Alstom decree" expanding foreign investment approval rules, came what was dubbed the "Danone decree:" in 2006, following a rumored bid by the U.S. company PepsiCo for the French food and nutrition company, the French government introduced changes to the French takeover rules to make hostile takeovers harder.

[13] *Financial Times* (April 25, 2006).

same basis as those involving EU acquirers, including state-owned enterprises of non-European countries such as China.[14]

One of the limited exceptions to the European Commission's exclusive jurisdiction is Article 21 of the EUMR, under which EU Member States may intervene to take measures to protect specified "legitimate interests." Three categories of interest—public security, media plurality, and financial prudential rules—are identified as legitimate in the EUMR. The EUMR also provides for EU Member States to apply to the European Commission for further categories of legitimate interest to be recognized.

The European Commission has followed a strict approach to the operation of this exception, and taken action against EU Member States that have sought to intervene in mergers in violation of the European Commission's exclusive competence. Thus, EU Member States' ability to intervene in mergers on grounds other than competition is curtailed largely through enforcement of the European Commission's powers as a supra-national merger control authority.

This is well illustrated by the European Commission's response to Article 21 applications by the U.K. government for the recognition of interests relating to the regulation of utilities. In 1995, the proposed acquisition of U.K. based Northumbrian Water by Lyonnaise des Eaux (which had existing interests in the U.K. water sector) prompted the first approach to the European Commission by a Member State for recognition of an additional category of legitimate interest in relation to the U.K.'s special regime for review of water company mergers.[15] The European Commission approved this.[16] As a result, the United Kingdom can apply the regime alongside the European Commission's normal competition-based under the EUMR.

By contrast, in 1999 the European Commission rejected the U.K. government's application for a further legitimate interest in connection with Electricite de France's proposed acquisition of London Electricity.[17] The European Commission thus retained sole competence over approval of the merger so that the United Kingdom had no power to block the transaction, although the European Commission recognized that the U.K. energy sector regulator could impose regulatory conditions on the merged business relating to transparency and customer protection, outside the merger control process.

In several cases, the European Commission has intervened on the basis of a breach of Article 21 EUMR in order to prevent an EU Member State from attempting to block a merger falling within the European Commission's exclusive jurisdiction under the EUMR. The first of these was in 1999 in relation to Portugal's attempt to prevent the insurance merger between

[14] For example, in a speech at the Fordham Competition Conference in 2011 in which Competition Commissioner Almunia stressed that under the EUMR there was a level playing field for non-European companies, he pointed out that the European Commission had approved "a string of mergers" involving Chinese state-owned companies that year. (SPEECH/11/561, 8 September 2011).

[15] Under the U.K.'s water mergers regime, there is an assessment of the impact on so-called comparative competition, i.e. the detriment of the merger on the water sector regulator's ability to make performance comparisons in the industry as a result of the reduction in the number of water companies.

[16] European Commission decision of 29 March 1995 under Article 21(3) of Regulation EEC 4064/89.

[17] European Commission decision of 27 January 1999 under Article 21(3) of Regulation EEC 4064/89.

BSCH and A. Champalimaud on the basis, Portugal claimed, of a breach of its national financial rules.[18]

The long-running takeover battle between Germany's E.ON and Italy's Enel for the Spanish electricity company Endesa is perhaps the clearest demonstration of the European Commission's resolve to enforce Article 21 strictly. Both transactions fell within the European Commission's jurisdiction under the EUMR, and the Commission approved each of them on competition grounds. In each case, there were then moves by the Spanish energy (not merger control) regulator to impose onerous conditions on these bids, making it more difficult for them to proceed. But in three successive decisions—two in 2006 relating to first an initial, and then a modified, set of conditions which the national energy regulator sought to impose on the E.ON bid and one a year later relating to conditions put forward for the Enel bid—the European Commission concluded that Spain had violated Article 21.[19]

The operation of Article 21 is not relevant where the EUMR does not apply; in that situation the Member State concerned is free to apply its national merger control rules.[20] The approach of the national authorities to assessing the competition issues may vary from that of the European Commission.

This could be the case even if the national review framework is also competition-based. In the exercise of its discretion under a competition test, a Member State might, for example, be more inclined to prohibit a transaction involving a foreign acquirer than the European Commission, or to clear a merger that on a more stringent review by the European Commission might have been blocked—if, for example, there was a desire to create a national champion and/or forestall a foreign takeover.

This latter scenario was a consideration in the Endesa saga. Prior to the bids by E.ON and Enel, the first approach made for Endesa was by another Spanish energy company, Gas Natural. Endesa was opposed to this bid. In seeking to resist it, Endesa tried (unsuccessfully) to have the merger control review taken up by the European Commission, on the basis that the correct jurisdiction was the EUMR. This was because Endesa was concerned that the Spanish competition authorities would succumb to pressure from the Spanish government to approve the merger regardless of the extent of the competition issues.

A national competition authority might also wish to take account of non-competition factors in its review of the merger.[21] A case involving public interest issues as well as competition considerations was the acquisition of Lloyds by HBOS at the height of the financial crisis in 2008. This merger between two U.K. banks fell within the U.K.'s domestic merger control jurisdiction,

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[18] Article 21(3) European Commission decision of 20 July 1999 under Article 21(3) of Regulation EEC 4064/89.

[19] Article 21(3) European Commission decisions of 26 September 2006 and 20 December 2006, and 5 December 2007, under Article 21(3) of Regulation EEC 4064/89.

[20] The exclusive jurisdiction of the EUMR is not triggered in the case of mergers where the companies involved are not large enough to exceed the EUMR jurisdictional turnover thresholds or, even if large, achieve two-thirds of their EU turnover in the same single Member State.

[21] Although the European Commission could not stop this under Article 21 (since the EUMR would not be applicable), it could still take action under the free movement rules if such intervention did not come within one of the exceptions to them—see further below.

under which the U.K. government can override the competition-based assessment of the competition authorities on the basis of specified public interest grounds. Until then, it had been assumed that typically the public interest exception regime was to allow intervention in mergers that would not be prohibited on competition grounds alone. However, the Lloyds/HBOS merger was the reverse of this: it was approved by the U.K government on the basis of the critical need to maintain the stability of the financial system, in spite of the fact that it raised significant competition issues.[22]

With hindsight, some questioned whether this difficult judgment call by the U.K. government was made correctly. The intention was to avert the collapse of HBOS with wider systemic ramifications for the U.K. banking sector but, as it turned out, the combined bank still required financial support from the U.K. government. This bailout then required approval from the European Commission under the EU state aid (anti-subsidy) rules and, somewhat ironically, a condition of that approval, in order to help restore competition in the U.K. banking sector, was that Lloyds should sell off part of the merged business in order to create a new U.K. bank.

However, even if the merger had fallen under the EUMR such that the European Commission rather than the U.K. authorities had taken primary jurisdiction, it is questionable whether the European Commission would have sought to oppose the U.K.'s public interest intervention as contrary to Article 21 in a case such as this.

The European Commission's deployment of Article 21 of the EUMR reflects its commitment to breaking down trade barriers and promoting the single market within the European Union. Indeed, it is interesting to note that all of the Article 21 cases have involved mergers between companies based in the European Union, rather than non-European purchasers. However, in an increasingly globalized world, one can speculate that there could be cases where EU Member States are accepted by the European Commission as having legitimate interests in looking at non-competition factors arising in relation to mergers that involve non-domestic acquirers from outside the European Union as well as from another Member State. Cyber security, the protection of strategic technology, and security of energy supply are examples that might become recurring themes.[23]

III. CONSTRAINTS ON EU MEMBER STATES' INTERVENTION UNDER EU FREE MOVEMENT RULES

In the Endesa case, the European Commission also held that the Spanish attempt to impose conditions on the merger with E.ON was contrary to the free movement principles under EU law, demonstrating the European Commission's wider powers under the Treaty of the Functioning of the EU ("TFEU")—in particular, the principles of freedom of establishment and

[22] In an expedited process, the U.K.'s Secretary of State for Business approved the merger in a decision dated October 31, 2008. The Office of Fair Trading's report to the Secretary of State of 24 October 2008 had found that the merger could reduce competition in relation to consumer current accounts, small business banking, and mortgage lending, but the Secretary of State concluded that the public interest in maintaining the stability of the U.K. financial system outweighed these competition concerns.

[23] Under EU energy regulatory rules, security of energy supply is already a relevant criterion for assessment of non-EU ownership of European gas and electricity transmission systems.

free movement of capital in Articles 49 and 63 of the Treaty[24] to oversee attempts by EU Member States to intervene in mergers on non-competition grounds.

A notable example of the application of the EU free movement principles with regard to corporate acquisitions is in relation to the holding of so-called "golden shares" by EU governments in strategically important privatized companies such as utilities. Golden shares usually give Member States veto rights over changes in ownership of the company. In a long line of cases, most recently in relation to golden shares held in Portuguese energy and telecoms companies, the European Commission and the European court have tested whether such shares were compatible with the free movement principles.

The European court has established strict criteria for when golden shares may be used to restrict takeovers: the basis must be grounds of public policy, public security, or overriding requirements of the general interest; the rights attaching to the golden shares must be operated in a non-discriminatory way; and they must be no more restrictive than proportionate. The cases have often turned on the application of the proportionality principle. For example, in 2003, the European court held that the golden share held by the U.K. government in the U.K. airport operator BAA did not satisfy the test and had to be removed,[25] making it possible for the Spanish company Ferrovial to acquire BAA shortly afterwards.

Thus, even outside the sphere of merger control rules, any attempt by an EU Member State to restrict non-domestic corporate ownership is likely to attract the European Commission's attention. It is noteworthy that only a small number of EU Member States have standalone foreign investment review laws and, as with the exceptions to competition-based assessment under national merger control rules, these are generally confined to criteria falling within the public policy, security, or general interest exceptions from the free movement rules under the Treaty.

IV. CONCLUSION

This article has provided an overview of the EU laws that set out the framework for the powers and roles of the European Commission and EU Member States in relation to the review of mergers by foreign purchasers. It has shown that, although there may be debate about the merits or otherwise of intervention against corporate acquisitions by foreign acquirers, there are in reality significant constraints—as a result of the supranational requirements of EU law—on the ability of EU governments to intervene in pursuit of such objectives. To that extent, opponents of protectionism may feel reassured.

It is interesting to draw the comparison with other market-based economies outside the European Union that have active foreign investment approval regimes that are not constrained by supra-national legal considerations. For example, in the United States, the Committee on Foreign Investment in the United States has the power to block foreign acquisitions of U.S. companies for national security reasons under the Exon–Florio Amendment to the Defense

[24] For a detailed review of the application of EU law in this area, we would recommend the paper produced for the Fordham Competition Conference 2014 by Alison Jones & John Davies, *Merger Control and the public interest: Balancing EU and national law in the protectionist debate,* (publication forthcoming).

[25] Case C-98/01 *Commission v. United Kingdom*.

Production Act 1950. In Canada, the government is able to review foreign acquisitions of Canadian companies applying a national net benefit test, under the Investment Canada Act 1985. In Australia, the Foreign Investment Review Board applies a national interest test to foreign acquisitions of Australian companies under The Foreign Acquisitions and Takeovers Act 1975.

There have been a number of high profile international mergers where decisions under these regimes rather than under competition rules have resulted in the transaction being blocked.[26] It is open to debate, given the fact-specific nature of any such review, whether the operation of these regimes without any equivalent to the EU law limitations on countries in Europe intervening in transactions may be said to reflect a more protectionist approach than has been taken in the European Union to acquisitions by overseas buyers. What can be said, however, is that separation of these foreign investment regimes from the relevant jurisdiction's competition-based merger control review helps to reduce the risk that calls for national protectionism influence the reviews conducted by the competition authorities.

Whether in the European Union or elsewhere, both foreign investment and competition or antitrust reviews share in common the need for predictability, consistency, transparency and speed in order to ensure the confidence of businesses, and ultimately consumers, in the enforcement powers which the authorities have been entrusted with.

[26] In 2006 the United States prevented the Dubai-based DP World from acquiring P&O, a U.K. company that operated a number of U.S. ports. In 2010 Canada blocked Anglo-Australian BHP Billiton from acquiring the Canadian fertilizer producer Potash Corporation. Last year Australia prohibited the acquisition by U.S. company Archer Daniels Midland of the Australian agribusiness GrainCorp.