CPI COMPETITION POLICY INTERNATIONAL

CPI Antitrust Chronicle
Oct 2014 (1)

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David Reader[1]

I. INTRODUCTION

When U.S. pharmaceutical giant Pfizer sought to acquire its U.K.-listed counterpart AstraZeneca earlier this year, much discussion centered around the possible adverse impact that the merger could have on the U.K.'s science base, particularly in light of Pfizer's questionable track record for asset-stripping and cutting investment in Research and Development ("R&D"). Although the proposed £69 billion (U.S. $117 billion) takeover ultimately crumbled, the prospect of Pfizer returning with an improved offer in the near future has led many to ask whether the United Kingdom should adopt a tougher stance on foreign takeovers that threaten the national interest. The U.K.'s Business Secretary, Vince Cable MP, has since proposed new safeguards to counteract these perceived threats;[2] but do they represent the best course of action in practice?

II. THE BUSINESS SECRETARY'S PROPOSALS

A. Remove Scope for Firms to "Wriggle Out" of Their Commitments

In the first of three proposals, Cable seeks to ensure that bidding firms adhere to the commitments they make in relation to a takeover by—in his words—removing the "wiggle room" that exists within the current procedure. Indeed, despite the existing rules obligating firms to abide by any commitments they make during the bidding process,[3] firms can renege on these commitments where a "material change of circumstances" arises.[4] Cable perceives this to be a "get-out clause" that acquirers are able to exploit in order to backtrack on their commitments after a takeover has been finalized.

The act of firms backtracking on their commitments, even where there has been a material change of circumstances, is a controversial subject in the United Kingdom. In 2010, Kraft Foods, the American grocery manufacturer, launched a successful takeover of U.K.-based confectioner Cadbury. At the pre-authorization stage, Kraft made a commitment to maintain operations at Cadbury's Somerdale factory in the West of England, which Cadbury had been in the process of closing down. The commitment was particularly attractive given that it would ensure the continued employment of some 400 workers at the plant. However, once the takeover had been completed and Kraft's management were in a position to speak to Cadbury about the

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[2] Vince Cable, *Strengthening confidence in the UK's takeover laws*, LIBERAL DEMOCRAT VOICE (July 2014), *available at* www.libdemvoice.org/vince-cable-writesstrengthening-confidence-in-the-uks-takeover-laws-41522.html (accessed July 14, 2014).

[3] This obligation persists for 12 months or a period otherwise specified.

[4] The City Code on Takeovers and Mergers, Rule 19.1.

planned closure, it became apparent that keeping the Somerdale plant open was not financially viable. The factory was closed at the beginning of 2011 and this arguably coincided with the emergence of a deep-set suspicion towards foreign takeovers by much of the U.K. population.[5]

The removal of the material change of circumstances clause would seemingly prevent firms from backtracking on their pre-takeover commitments in this way. But it seems wholly disproportionate to remove the clause in its entirety. Its existence is, after all, a testament to the fact that there will sometimes be legitimate commercial reasons for firms to depart from their commitments, such as in times of unforeseen austerity or major regulatory reform.

In a similar vein, the Kraft/Cadbury case illustrates the difficulties an acquiring firm faces when making commitments before it has seen the target company's confidential accounts and other relevant documents. Without the luxury of being privy to these documents, acquiring firms are prone to make commitments that (unbeknownst to them) are unworkable or unviable in practice. In the face of this information asymmetry, the material change of circumstances clause is one of the few legal provisions offering protection to the acquirer.

Given that the existence of the clause can be seen to serve a legitimate purpose, Vince Cable should perhaps consider alternative ways of ensuring that it is not exploited by firms with fraudulent motives. Fundamentally, the law needs to recognize the distinction between (a) a firm that makes commitments in good faith but is unable to honor them for an unforeseen commercial reason, and (b) a firm that makes commitments as a façade to complete the takeover and that has no intention of honoring those commitments. The former should be able to legitimately take advantage of the clause whereas the latter should not. In practice, it may be possible to frame this as a legal test, whereby a firm would need to meet certain criteria in order to be considered legitimate for the purposes of applying the material change of circumstances clause.

B. Introduce Financial Penalties for Firms Who Fail to Comply

The Business Secretary's second proposal is to introduce tough financial penalties for firms who fail to honor the commitments they have made. At present, the harshest sanction the U.K. Takeover Panel can impose for such infringements are so-called "cold-shoulder" penalties,[6] which prevent individuals from working on any takeover-related activity in the United Kingdom for a fixed period of time. Aside from some loss of reputation, the firms themselves face few repercussions as a result of reneging on their pre-takeover commitments.

Cable's financial penalties proposal would offer one such repercussion but it faces a number of obstacles in terms of deterring such behavior. For instance, it is unclear how these penalties would be calculated and how high they would need to be in order to constitute a genuine deterrent. When one considers the tax savings that Pfizer was due to inherit as a result of

[5] A recent survey found that 39/100 U.K. respondents consider foreign investment to be desirable, whereas 53/100 deem it undesirable. Pew Research, *Faith and Skepticism about Trade, Foreign Investment*, *available at* www.pewglobal.org/2014/09/16/faith-and-skepticism-about-trade-foreign-investment/ (accessed September 16, 2014).

[6] *Id.*, Section A, Part 11(b)(v). The Panel may also make a referral to the High Court under s. 955 of the Companies Act 2006 but this is, as yet, untested.

its merger with AstraZeneca (estimated at £1.4 billion (U.S. $2.3 billion) a year by one source),[7] one begins to appreciate how even a multimillion-pound fine could represent a mere slap on the wrist for an acquiring firm that backtracks on its commitments.

Moreover, these fines would need to be capped to avoid having an adverse effect on the key national interests that the policy is seeking to protect. For example, take the hypothetical scenario where Pfizer has successfully acquired AstraZeneca. The U.K. Government has been able to secure commitments from Pfizer to maintain the merged entity's investment in the R&D of pharmaceuticals (a key national interest). Pfizer later reneges on this commitment and the Takeover Panel takes steps to impose a significant financial penalty on Pfizer. The issue here is that, if the merger has resulted in Pfizer and AstraZeneca becoming a single economic entity, the fine effectively penalizes both.[8] Depending on the severity of the fine, the merged entity may be forced to offset the cost of the fine by further reducing its investment in R&D.

Imposing a cap on such fines is somewhat analogous to the rationale that underpins the way fines are calculated and capped for cartel offenses under EU competition law. For example, when calculating fines for breaches of Article 101(1) TFEU,[9] the European Commission will take account of a firm's (in)ability to pay a fine,[10] mindful of the fact that fining a firm into insolvency would result in a competitor exiting the market (which would be counterintuitive to its pro-competition policy aims). Of course, cartel enforcement is also a prime example of how different authorities have combined both corporate and personal sanctions, as well as civil and criminal penalties, in an effort to effectively deter wrongdoing. It is interesting to consider whether Vince Cable's proposal for financial penalties would need to be reinforced by an additional personal sanction for directors in order to act as an effective deterrent. Equally, it may be worth considering the possibility of forced divestiture as a separate sanction for firms who renege on their takeover commitments. These sanctions are not without their practical limitations, but they at least demonstrate alternative ways of pursuing deterrence without compromising key national interests.

C. Utilize the Public Interest as a "Last Resort"

Vince Cable's third proposal seeks to amend the public interest provisions for merger control under the Enterprise Act 2002. He recommends the use of a public interest test as a "last resort" measure that will only be utilized in cases where bidders refuse to undertake satisfactory commitments to protect the national interest. Exactly how Cable intends to achieve this is unclear,[11] but he told the BBC[12] that he would favor narrow and specific powers that would allow

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[7] Business, Innovation and Skills Committee, *The Future of AstraZeneca* (HC 2013-14), Q64. *Available at* *http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/business-innovation-and-skills-committee/the-future-of-astrazeneca/oral/9564.html* (accessed July 16, 2014).

[8] Pfizer may, however, wish to keep the two companies separate (as a parent-subsidiary relationship); in which case, the principle of "separate corporate personality" under U.K. company law would see Pfizer bear the full force of the fine. *See, Salomon v A Salomon & Co Ltd* [1897] AC 22.

[9] Consolidated Version of the Treaty on the Functioning of the European Union [2010] OJ C83/47.

[10] Guidelines on the method of setting fines imposed pursuant to Article 23(2)(a) of Regulation No 1/2003 [2006] OJ C210/02, at ¶35.

[11] Interestingly, Vince Cable—as the U.K. Business Secretary—could exercise his residual power to propose new public interest grounds under section 58(3) of the Enterprise Act. Subject to Parliamentary approval, this could

the Government to intervene and block mergers that were "very clearly against the national interest" (citing the loss of R&D and pharmaceuticals as clear examples).[13]

Of course, Cable appreciates that any such intervention on public interest grounds would need to comply with EU law if the merger meets certain turnover thresholds prescribed in the EU Merger Regulation ("EUMR"). Indeed, it follows that many mergers which are capable of having a clear adverse impact on the national interest will also be trading on a scale that would surpass these thresholds. In practice, the European Commission adopts a strict competition-based approach when assessing the legitimacy of mergers brought before it. However, Article 21(4) EUMR provides that Member States may assume the jurisdiction to rule on EU-level mergers that are likely to have an impact on their legitimate national interests.

There does, however, appear to be a very high threshold for what constitutes a "legitimate interest" for the purpose of Article 21(4). The EUMR lists three explicit legitimate interests (public security, media plurality, and prudential rules) and also allows Member States to suggest additional interests on a case-by-case basis. The fact that Member States can propose additional interests would appear to make Vince Cable's proposal workable in theory, but—after a series of cases between 1999 and 2008 which saw several Member States invoke Article 21(4) for illegitimate purposes—the Commission now appears to treat legitimate interest claims with a great deal of suspicion.

But even if one assumes that Cable's new public interest test is compatible with EU law, there remains scope for firms to abuse this procedure. For example, if an acquiring firm genuinely believes that its takeover is likely to be blocked on public interest grounds, then that firm will naturally seek to offer satisfactory commitments to avoid this outcome, even if it has no intention of fulfilling those commitments. By the time the firm begins to renege on its commitments, the merger would already be complete and the option to block the merger on public interest grounds would no longer be available. The firm, meanwhile, would escape with a financial penalty established by Cable's second proposal. As such, relying on the public interest test as a last resort measure would therefore necessitate a difficult assessment of a firm's trustworthiness as well as the quality of its commitments.

Any decision to extend the application of the public interest exceptions under U.K. merger control should be taken with the utmost scrutiny. By enabling an independent competition authority (the Competition and Markets Authority) to assess mergers according to their effect on competition, the U.K. merger control regime has all the ingredients necessary for transparency and predictability. This makes it a very attractive place to invest and do business. The public interest exceptions to the default competition-based approach (national security,

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create the specific intervention power(s) that Cable is referring to, without the need for new primary legislation. *See* David Reader, *UK public interest mergers: uncertain times ahead*, 26 CCP RESEARCH BULL. 18 (2013), *available at* www.competitionpolicy.ac.uk/documents/107435/107588/CCP+Research+Bulletin++Autumn+2013.pdf/951d8635-c00f-495b-9718-53a28358c099 (accessed July 20, 2014).

[12] *Vince Cable: UK to remove takeover 'wiggle room'*, BBC NEWS, *available at* http://www.bbc.com/news/business-28282621 (last accessed October 8, 2014).

[13] The Andrew Marr Show, *Interview: Vince Cable MP, Business Secretary* (July 2014). A full transcript is *available at* http://news.bbc.co.uk/1/shared/bsp/hi/pdfs/130701.pdf (accessed July 14, 2014).

media plurality, and financial stability) very much resemble the legitimate interests listed under Article 21(4) EUMR at a European level. To add to the list of domestic exceptions—even as a last resort—would mark a step beyond the European norm and would carry the risk of compromising the openness and credibility of the U.K. regime in the eyes of the global marketplace.

This is not to say that there are no justifiable grounds for adding to the list of public interest exceptions in the future. Over time, the factors that are deemed to be "in the public interest" are subject to change, particularly in light of changing social attitudes and economic projection. A merger transaction may yet arise where it is, indeed, objectively justifiable to intervene in order to safeguard the public interest from a firm (be it domestic or foreign) that is not prepared to offer adequate commitments. But should Cable's proposal materialize in practice, it is imperative that new public interest exceptions are not introduced as a mere quick fix to address a solitary public interest concern at the expense of competition principles.[14]

III. CONCLUSION

Depending on what emerges from the Government's consultation on these proposals, it is possible that the first two of Vince Cable's suggestions will be introduced before next year's General Election.[15] However, based on the aforementioned discussion, there are doubts over whether these proposals would stand up to the task of safeguarding the national interest and, more centrally, whether it is even necessary or desirable to seek such safeguards in the wake of Pfizer/AstraZeneca.

With regards to the financial penalties proposal, in particular, it will be interesting to see whether alternative penalties (e.g. forced divestitures or personal penalties associated with cartel enforcement policy) will also be discussed during the consultation. If financial penalties fall short of providing an effective deterrent to firms reneging on their commitments, then Cable's first and third proposals become equally ineffectual.

Furthermore, at a fundamental level, the United Kingdom must ensure it takes every step to preserve its reputation as a nation that is open for business. There is often a fine line to be drawn between measures that seek to protect the national interest and those that go further to promote economic patriotism. The European Commission has itself become increasingly more vigilant towards Member States who have implemented *ex ante* measures to artificially control or frustrate cross-border mergers.[16] France remains under close scrutiny from the Commission for its own new foreign takeover laws;[17] the United Kingdom can expect to endure similar scrutiny should Cable's proposals come into force.

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[14] Bruce Lyons, *Competition Policy, Bailouts, and the Economic Crisis*, 5(2) COMPETITION POL'Y INT'L 25, 47, note 47 (2009).

[15] If legislation is required, Cable is set to utilize the Small Business, Enterprise and Employment Bill 2014-15 as a vehicle for the reforms.

[16] *See* Michael Harker, *Cross-Border Mergers in the EU: The Commission v The Member States*, 3(2) EUR. COMPETITION J. 503 (2007).

[17] Ingrid Melander & Foo Yun Chee, *France says won EU backing on takeovers law, EU says will monitor*, REUTERS, a*vailable at* http://uk.reuters.com/article/2014/07/10/uk-france-mergers-idUKKBN0FF1HW20140710 (accessed July 15, 2014).

Ultimately, for the United Kingdom to return to an interventionist approach to merger policy and takeover policy would be completely undesirable,[18] not least for the protectionist message it sends to overseas investors which the U.K. economy derives significant benefits from.

[18] *See* Andreas Stephan, *Did Lloyds/HBOS mark the failure of an enduring economics-based system of merger regulation?* 62(4) NORTHERN IRELAND LEGAL Q. 539 (2011).