Professional Perspective

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Merger Control & FDI Outlook for 2023

Contributed by Annie Herdman, Ruchit Patel, Jonathan Klarfeld, and Samer Musallam, Ropes & Gray

Over the last 12 months, merger control and foreign direct investment has dominated the headlines. In 2022, we saw macro-economic conditions worsen as a result of political instability and the energy and cost of living crises, together with a continued reversal of globalisation. As we move into 2023, we can expect global merger control and foreign direct investment agencies to continue to embrace a bold and more interventionist stance to protect consumers and advance broader societal goals.

In this article, we summarise the key issues that deal makers need to be aware of in 2023. In particular, companies should note that antitrust agencies are taking jurisdiction over a broader range of transactions that would have historically escaped scrutiny and are aggressively enforcing violations. Not only is the number of filing obligations increasing, but the reviews themselves are becoming more challenging, with the agencies investigating novel theories of harm and being held to a lower standard of proof. A renewed skepticism of private equity (PE) buyers is also being seen on both sides of the Atlantic.

With foreign policy becoming increasingly protectionist and a looming economic downturn, deal makers can also expect foreign direct investment regulators to continue to carefully scrutinise transactions in sensitive sectors and to impose mitigation measures where there is any risk of national interests being impacted. In parallel, certain regulators have expanded their interpretation of national security risk—including to encompass risks that do not specifically arise from the transaction under review—thereby unilaterally expanding their mandates.

New regimes such as the EU foreign subsidy regime and other potential reforms such as outbound investment screening are set to further complicate M&A in 2023.

Greater Number of Merger Control Filings

In 2023, we expect antitrust agencies to claim jurisdiction over a broader range of transactions than ever before.

- In the EU, we understand that the European Commission (EC) has already considered more than 30 transactions for below threshold review, following its prohibition of Illumina's reacquisition of Grail—which did not generate any EU revenue whatsoever. Companies in innovation-focused industries—such as life sciences and tech—and green sectors will need to scope the risk of cross-border review, even in the absence of a meaningful ex-US nexus.
- In the UK, the Competition and Markets Authority (CMA) will continue to take jurisdiction over more transactions post-Brexit, even those with limited UK nexus. The UK government is also considering new thresholds that would further expand the CMA's reach.
- Regulators elsewhere have either introduced, or plan to introduce, transaction value-based thresholds to catch potentially anticompetitive deals that previously escaped scrutiny because the targets were too small—e.g., in Germany, Austria, South Korea. New rules are also under review in China, South Africa, and Australia.

Companies involved in deals in sensitive or dynamic sectors in particular—irrespective of small/no target revenue—should expect increased scrutiny.

More Aggressive Enforcement

Authorities aggressively enforced antitrust violations in 2022, breaking multiple records. Some authorities—such as the General Authority for Competition in Saudi Arabia—blocked their first vertical merger and other authorities implemented their highest-ever sanctions and fines. For example, in 2022, China, Brazil, Spain, Portugal, Argentina, and Mozambique—to name a few—all broke records with the size of penalties imposed for failure to file.

The EC has recently decided to expand the scope of its antitrust whistleblower tool to include merger infringements and so going into 2023, we may see a small increase in the number of gun-jumping penalties in Europe.

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Tougher Reviews & Greater Skepticism of PE Buyers

In 2022, while the EC cleared a greater proportion of simplified procedure cases than ever before, 22% of normal mergers required a remedy or resulted in a Phase II investigation and 2022 saw the highest number of abandoned deals. In the UK, the CMA found competition concerns in 58% of the mergers it reviewed—a significant increase from 31% in 2021 and 42% in 2020. Perhaps most interesting about the statistics is that the UK intervened—prohibited, required remedies, etc.—in a greater number of transactions than even the EU—25 to the EC's 18.

In 2023, we expect antitrust enforcers worldwide to undertake a more detailed review of transactions, particularly those involving innovation, data, and digital markets.

- **Nascent/Potential Competition.** A key focus of the substantive analysis, particularly in the UK. The CMA's new merger assessment guidelines give it a high degree of flexibility and discretion regarding the assessment of likely and possible entrants, giving rise to less predictable outcomes.

- **Lower Burden of Proof.** Agencies may be held to lower burdens of proof. In 2022, the General Court upheld the EC's prohibition of the proposed joint venture between Thyssenkrupp and Tata Steel. It found that the EC had proved that there was a "sufficient degree of probability" of competition being harmed, marking a departure from the historical "strong probability" and "sufficiently high degree of probability" standards. While this decision is currently on appeal, we can expect the agencies to continue to press for lower burdens of proof particularly in dynamic markets where the likely outcome of future competition remains unclear.

- **Novel Theories of Harm.** We expect agencies to consider increasingly novel theories of harm and topics outside of traditional antitrust analysis such as innovation, sustainability, and effects on labor markets. For example, we see some antitrust authorities taking a novel approach to the counterfactual—what competition would look like absent the merger—including second-guessing the outcome of a seller's sales process and the assessment of possible purchasers.

- **Scope Creep.** We can also expect reviews of PE deals in particular to involve issues like interlocking directorates and non-compete provisions. Indeed, on Jan. 5, 2023, the FTC proposed a new rule that would ban non-compete clauses—and de facto non-competes—between employers and employees—with a limited exception for a 25% or more owner upon sale of a business. This new rule would equally apply to existing non-compete clauses which must be rescinded prior to the compliance date—subject to very limited exceptions. It remains to be seen whether the FTC chooses to make final such a sweeping rule, or whether it adjusts its scope in response to public comments. Expect significant legal and constitutional challenges to the FTC's authority to implement the rule immediately upon final issuance.

- **Preference for Structural Remedies.** Will continue in Europe, as well as in the US. For example, in *Illumina/Grail*, behavioral remedies were rejected on both sides of the Atlantic.

- **Appetite to Litigate.** The US agencies are likely to remain willing to litigate. The DOJ has articulated a high bar to accepting parties' proposed settlements. In 2022, the DOJ did not enter into any formal settlements preferring instead to litigate than accept remedies. While the FTC appears more willing to accept settlements, it has required significant divestitures and has insisted on onerous terms requiring acquirers to obtain "prior approval" from the agency before closing any future transaction affecting each relevant market for which a violation was alleged, and "prior notice" provisions for future acquisitions in some markets even though no enforcement actions were taken.

- **Skepticism of PE.** As the DOJ and FTC consider changes to their merger review guidelines, a spotlight on PE deals and other related investment vehicles could have major implications. In particular, a focus on the deal history of potential PE buyers would represent a departure from current practice and could create new hurdles for PE firms.

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In addition, in the UK, we understand that the CMA is canvassing views from interested stakeholders in connection with the effect of leverage on investments on consumers. The CMA's predecessors, the OFT and CC, had historically considered public interest issues in circumstances where capital gearing and interest cover ratios of the merged company would result in insufficient funds for capital expenditure –Swedish Match/Gillette (1991)– or result in the target company being put under pressure to give priority to short-term considerations in order to generate funds to reduce borrowings, or be forced to implement measures of rationalization leading to substantial job losses–Elders/Allied Lyons (1986).

Acquisitions of supermarket chains Morrisons and Asda by financial sponsors renewed the debate, as both supermarkets have been accused of becoming less aggressive on pricing since being acquired by financial sponsors. In practice, the CMA is not likely to take leverage into account in the context of a standalone acquisition, except where financial structure raises concerns regarding solvency. However, this may become more of an issue with a purchaser approval process in the context of divestiture, where the CMA may raise concerns regarding a PE firm's commitment to the relevant market and its incentive and industry know-how to vigorously compete.

If PE is out of the picture, the consequence may be that we find an even greater number of prohibitions, if suitable corporate purchasers with the access to the right capital and historical investment track records cannot be found.

On the plus side, we expect the EC will make significant changes to its simplified procedure in 2023, which will help to reduce the burden for businesses involved in qualifying deals.

Increasing Agency Cooperation, but Potential for Divergent Outcomes

Cooperation between authorities will be a strong feature of merger control in 2023. Merging parties should assume that information disclosed to one authority may be shared with other authorities around the world, and that theories of harm developed in one jurisdiction may inspire others.

Increasing cooperation will, however, not always lead to more consistent outcomes. For example, during the two-years since the UK left the EU, the EC and UK CMA have concluded reviews in 20 parallel cases and reached different conclusions in five of them. Most notable was the CMA's prohibition of the planned merger of Cargotec and Konecranes, two Finnish providers of container-handling equipment and services to port terminals and other industrial consumers worldwide, notwithstanding that the EC conditionally cleared the deal. The CMA regarded the “mix and match” remedy offer as too complicated to implement and enforce, whereas the EC was satisfied that it resolved all competition concerns.

With the increasing number of parallel reviews by agencies with different legal frameworks and political priorities, divergent outcomes are likely to continue to be a trend.

Continued Scrutiny of Foreign Direct Investment

Foreign direct investment filings continue to proliferate with almost all EU Member States having adopted new national security screening mechanisms or amended existing ones, and with the Committee on Foreign Investment in the United States (CFIUS) continuing to take a proactive approach to scrutinizing foreign investment in the US.

The UK's National Security and Investment Act 2021 (NSIA), which came into force on Jan. 4, 2022, has taken center stage. The UK government has been far more interventionist under the NSIA than under the Enterprise Act 2002. The UK government did not block a single transaction on national security grounds under the old regime, compared to its five prohibitions under the NSIA in 2022 alone.

In addition, while all five of the prohibitions concerned Chinese or Russian-backed acquirers, there have been nine cases where fairly extensive commitments have been imposed, some of which on “friendly” investors such as those from the US and Europe. This level of interventions is roughly half the number of mitigation measures made by CFIUS in the US last year, an economy that is nearly seven times larger than the UK's.

These commitments have included the UK government requiring parties to, among other things:

- Appoint a government observer to the board of a target's UK subsidiary.
- Restrict certain activities outside of the UK or to influence board appointments within the target company.

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- Accept some form of control over, or restriction on, access to information, either to prevent companies from sharing information within the same group or to protect sensitive information from external disclosure.

- Continue supply to government customers.

In addition, some remedies have gone beyond the scope of national security and included economic commitments such as the in the *Viasat/Inmarsat* case where the parties were required to commit to "an expansion in the number of highly skilled jobs in key areas and a 30% increase in overall research and development spending in the UK".

Interestingly, a number of these transactions that have been blocked or subject to conditions did not trigger a mandatory filing requirement—i.e., transactions involving the acquisition of intellectual property and licences. This reinforces the scope and flexibility of the regime and the ISU's willingness to enforce it.

The same is being seen on the other side of the Atlantic where the number of transactions that CFIUS independently scrutinized through its non-notified transaction review process increased, with 135 independent outreaches in 2021—compared to 117 in 2020 and 80 in 2019. Notably, the types of transactions that come under CFIUS scrutiny also has evolved, with CFIUS taking an increasingly broad view of what constitutes a threat to US national security and reviewing transactions that would, inter alia, expose US sensitive personal data to risk, reduce US technological leadership, or involve foreign parties with even indirect connections to countries of concern, like China and Russia.

CFIUS's increasingly robust approach to scrutinizing foreign investment was formalized—and implicitly ratified—by a September 2022 Executive Order, the first such Executive Order in CFIUS's nearly 50-year history. The Executive Order observes that companies outside of government contractors, semiconductor companies, and other traditionally high-risk industries may warrant enhanced CFIUS scrutiny, which is consistent with recent experience.

In October 2022, CFIUS also published its first ever CFIUS Enforcement and Penalty Guidelines, which set forth the process by which CFIUS will assess penalties for non-compliance with CFIUS regulations—including non-compliance with mitigation agreements and failure to submit mandatory pre-closing filings—and describe relevant aggravating and mitigating factors. Although CFIUS always has had the ability to impose monetary penalties for non-compliance with CFIUS directives—in addition to its authority to impose mitigation measures—the Committee has used its penalty authority only sparingly. The timing of publication of the Guidelines, on the heels the first-ever CFIUS Executive Order, may signal a pivot to a more aggressive enforcement posture going forward.

Outbound Investment Controls on the Horizon

In addition to inbound screening, outbound investment screening seeks to control strategic investments abroad in countries like China and Russia as a means of addressing the risk that strategic and financial investors may facilitate the development in China or Russia of technologies that are sensitive and impact domestic national security.

In the US, there are active discussions in Congress to establish a broad form of outbound investment screening—and recent reports suggest that the Biden administration is considering a targeted Executive Order in the first instance—but it remains to be seen whether a new regime will be implemented.

The EC has also announced that it will review its control mechanisms for outbound investments.

EU Foreign Subsidy Regime

On Nov. 28, 2022, the EC formally adopted the new Foreign Subsidies Regulation (FSR). The FSR aims to tackle foreign subsidies which have the potential to distort the internal market.

The FSR introduces a new mandatory and suspensory notification obligation—that is independent of merger control and foreign direct investment—where a transaction results in a concentration and meets certain thresholds. The regime will come into effect in mid-2023 and will have a considerable impact on M&A in the EU.

The EU has already inspired new foreign subsidy rules in the US and the UK. While they are both significantly more flexible than the EU regime, staying on top of the various different regulatory regimes adds yet more complexity to deal-making in 2023.

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