PRIVATE EQUITY PERFORMANCE IMPROVEMENT

EU Regulatory Spotlight on Private Equity Carve-Outs: What You Need to Know

Every year, about 400 mergers are notified to the European Commission (EC) for review. The Commission evaluates these transactions to determine their potential impact on competition within the European Union (EU). In cases where negative impacts are identified, the EC can raise objections under the EU law.

The EC only reviews larger transactions and has continuously introduced simplified procedures since 2000. The latest update in 2023 introduced the "super-simplified" procedure, which significantly reduces the amount of information the merging parties need to provide. Regardless of the filing procedure, all notified mergers undergo a review process that can take several months.

What can companies do to address antitrust concerns?

If the Commission has concerns that the merger may significantly affect competition, involved companies can propose remedies. The most common remedy accepted by the EC is the divestiture of the affected business unit – the carve-out.

This introduces additional challenges, such as the appointment of a monitoring trustee, added time pressure, increased transaction complexity and extra costs. There is also the risk that the EC might still not approve the merger.

How do competition concerns influence mergers and carve-outs?

1 DELAY OF SYNERGIES

A complete takeover depends on the completion of the divestiture. Negotiating and implementing the abovementioned remedies can negatively affect operational efficiency, delaying the realization of synergies.

2 COMPRESSED TIMEFRAME

Regulatory requirements often impose tight deadlines for conducting the carve-out. This creates a challenging balance between divestiture efficiency and the negotiation of a fair price, which may ultimately benefit buyers.

3 PLANNING UNCERTAINTY

Adapting to changing circumstances increases the risk of overlooking critical details or regulatory obligations. Additionally, departments involved in the divestiture may face uncertainty about their roles post-integration, potentially affecting their commitment to the process.

4 DIVERGING GOALS

Involving a third party with differing goals adds complexity to corporate governance. The new owner's desire to realize synergies must be balanced with maintaining the integrity of the divested business. Premature actions could violate antitrust regulations and be seen as "gun jumping," highlighting the importance of controlled communication and governance practices.

5 COST-BENEFIT CONSIDERATION

Transitional Services Agreements (TSAs) require a careful evaluation of their cost-benefit balance.

6 ADMINISTRATIVE BURDEN

Some of the remedies imposed by the EC to address competition concerns often lead to additional administrative efforts. This includes the requirement to appoint a monitoring trustee to oversee the implementation of the remedies.

What challenges arise in carve-out remedies?

Once a carve-out is accepted by the EC as a suitable remedy, additional aspects such as hold-separate obligations and trustee oversight must be considered.

Hold-separate obligations are typically required to avoid conflicts of interest or antitrust issues. For example, unless explicitly permitted by the EC, the retained management and employees must not be involved in the divested business. Vice-versa, staff from the divested entity must not work for the remaining company nor report to anyone outside the divested entity. This must be ensured until the business is fully carved out and sold.

Adapting to hold-separate compliance measures while managing day-to-day operations can be an additional burden on resources and personnel.

Some recommended actions to comply with hold-separate obligations include:

Defining the hold-separate operating model (HSOM): The HSOM is intended as a transitional solution. Its focus is on risk management, ensuring compliance and maintaining value during the transition. Additionally, it aims to ensure the economic viability and competitiveness of the divested business. It's important to note that the EC does not expect companies to conduct hold-separate measures beyond economic viability.

Implementing ring-fencing measures: Information barriers must be established to prevent the exchange of sensitive information between the carved-out unit and the rest of the company. Shielding sensitive business data can generally be achieved through various mechanisms that vary in complexity and cost.

Establishing service level agreements (SLAs): SLAs play a crucial role in ensuring the effectiveness of the HSOM. They provide clear guidelines, expectations, and performance metrics for the entities involved. SLAs may also include clauses on data protection, confidentiality, and other legal requirements essential for compliance with hold-separate obligations.

The role of the monitoring trustee

The oversight of a monitoring trustee is another important piece in merger antitrust compliance. The trustee must be appointed by the merging companies and approved by the EC.

The primary responsibilities of the trustee include:

1 MONITORING COMPLIANCE

Supervising the implementation of remedies or commitments agreed by the merging companies or imposed by competition authorities to address antitrust concerns.

2 REPORTING TO AUTHORITIES

Regularly reporting to the relevant competition authorities on the progress of remedy implementation and any issues encountered during the process.

3 INVESTIGATIONS

Conducting investigations to verify that the merging companies comply with the agreement or order conditions, which may involve reviewing financial records, interviewing employees or inspecting business operations.

4 ADVISING ON STRATEGY AND COMPLIANCE

Providing advice and guidance to the merging companies on how to meet the requirements outlined in the agreement or order. This may include recommendations on divestiture strategies, ensuring non-discriminatory access to essential facilities or establishing compliance programs.

5 MEDIATION

Acting as a mediator in disputes between the merging companies or between the companies and the competition authority to resolve conflicts and facilitate communication.

6 ENFORCEMENT FOR NON-COMPLIANCE

Recommending enforcement actions such as fines or additional divestitures to the competition authority if the merging companies fail to comply with the agreed remedies or commitments.

Companies may face difficulties complying with the EC legislation and monitoring trustee requirements, particularly when significant operational changes or divestitures are involved. Non-compliance with agreed remedies or trustee-monitored commitments can lead to enforcement actions by competition authorities and significant fines.

Therefore, merging companies must strictly comply with the conditions outlined in the agreement. Effective communication with the monitoring trustee and a smooth onboarding process during a regulatory carve-out are also key to the procedure's success.

How A&M can help

The complexities of merger remedies such as divestitures demand expertise, precision and a strategic approach. A&M's Private Equity Performance Improvement team brings extensive experience in planning and executing complex carve-out transactions, including navigating monitoring trustee requirements and other antitrust compliance challenges like hold-separate obligations.

Our multidisciplinary team, comprising professionals with deep expertise in the financial, operational, regulatory, IT and tax challenges that arise in carve-outs, ensures regulatory compliance, transparency and accountability at every stage of the process, helping clients mitigate delay risk and achieve a successful merger conclusion.

For more detailed insights, please get in touch with Dr. Tim Veen or Sébastien Trochet.

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