

Alstom, AstraZeneca and Anglo-French political risk

1 July 2014

Summary

Last week brought to a close the two-month public courtship of GE and Alstom, with a government-brokered deal that will see the French state acquire a minority voting right and ultimately a minority stake in the French company. The Alstom episode cast a long shadow in the UK, where the government faced pressure to take a similarly activist approach to the proposed acquisition of AstraZeneca by Pfizer. The result is new legal tools in France and signs of a shifting mood on takeovers in the UK. This has less to do with nationality than is usually assumed. So what is driving it?

Last week brought to a close the two-month public courtship of GE and Alstom, with a government-brokered deal that will see the French state acquire a minority voting right and ultimately a minority stake in the French company. The deal provoked familiar instincts in Paris, but also led to the creation of new legal tools that will strengthen the hand of the French government in future takeovers.

The Alstom episode cast a long shadow in the UK, where the government was facing pressure to take a similarly activist approach to the proposed acquisition of AstraZeneca by Pfizer. The collapse of that deal excused London from making difficult choices, but the tone of the debate signalled an important shift in the political mood and a weakening of London's resolve to stay neutral in corporate takeovers except in very narrowly defined circumstances.

What the Alstom case in particular demonstrated was that the scope for improvisation around European legal constraints on political intervention in takeovers remains considerable and that the appetite to use it is growing. Paris has asserted its prerogatives in a way that has maximised its informal checks on deals, while being careful not to blatantly flout the letter of EU law. With GE-Alstom signed and on its way to Brussels and AstraZeneca-Pfizer dead, some general conclusions can be drawn that are relevant to future acquisitions in Europe.

Foreign ownership, national influence

While Paris clearly has ample appetite for political activism, the Alstom case actually signals that there is a large measure of pragmatism in its economic nationalism. Paris helped corral American money for Yoplait in 2010 and invested state funds alongside

Chinese money in a rescue deal for Peugeot in early 2014. Despite Arnaud Montebourg's personal preference for a grand European solution - positively encouraging Siemens to mobilise in a counter-proposal alongside Japan's Mitsubishi - the French government was ready to take American money for Alstom from the moment GE CEO, Jeff Immelt, briefed President Hollande and they felt they could secure the right guarantees. The French government had already accepted that new capital was a prerequisite to the company's survival and that this was going to be foreign. The issue was always the terms - in particular the locus and employment in France of the new company's energy operations and the fate of the Alstom train business, which GE could not acquire for competition reasons.

Paris's leverage in these situations has always been through its willingness and ability to mobilise and to assert its prerogatives. When the French government produced a surprise tightening of French law on the oversight of foreign acquisitions and mergers in May, its key provision was the widening of the requirement to seek state authorisation for mergers with French companies. This provision had previously applied only in defence, national security and gambling. EU merger laws allow the blocking of takeovers or mergers on public interest grounds in the defence and national security sectors. There is also a longstanding exemption from EU single market rules for gambling, which is classed as a 'special economic activity' both because of its social impact and because many EU states have large state interests in their national gambling franchises. The new decree extended it into a wide range of network industries, specifically energy, transport, water and digital communications. By one estimate, the decree would cover a third of the CAC40 and dozens of companies outside it.

This may yet fall foul of EU rules. However, the lawyers in Paris have been careful not to present an easy target for Brussels. They have rooted the new scope of the decree in the concept of the public security provided by network businesses, but European jurisprudence on these definitions is not particularly clear. The over-riding obligation - to exercise these kinds of exemptions in a proportionate and non-discriminatory way - still needs defining. At face value, EU law makes it hard for a European state to be too picky about the national identity of a potential acquirer of European assets. However, Paris has already suggested in multiple cases that it is ultimately more interested in post-sale state influence than the national provenance of new capital.

The decree also creates not a block on takeovers or mergers in these sectors but an obligation to seek authorisation. Paris will argue that authorisation creates an obligation to engage with the French government on mergers in sectors where public security is relevant, nothing more. In principle France, like any other Member State is obliged to submit any measure that would block a merger on public interest grounds to the Commission for prior approval, and there is nothing in this decree that prevents that happening. With only this to go on, Brussels may be forced to say that whatever its concerns about French posturing, it can only judge Paris on what it actually does.

European and national takeover tests in the EU, France and the UK

EU Single Market rules	The freedom of movement for capital establishes principle of non-intervention. Exceptions on the grounds of public policy, public security or public health so long as they are not discriminatory and are proportionate. These include measures to guarantee the solvency and continuity of universal postal services, safeguard supplies of energy in the event of a crisis and ensure consumer protection in gambling.
EU Competition law	The EU Merger regime permits only limited restrictions on the right to merge - Member States can show "legitimate interests" in public security, media plurality or prudential rules. The Commission can in principle also authorise restrictive measures on additional specific grounds, although this is rarely invoked.
UK Framework	Prior to the UK Enterprise Act 2002, merger decisions were taken by Government Ministers advised by the UK competition authorities. The 2002 Act now allows for intervention only in limited areas identical to EU merger law. Non-discriminatory consent from national regulators may also be required for mergers in regulated industries.
French Framework	Under French law, foreign investment activities which may affect public policy ("ordre public"), public safety or national defence interests require prior authorisation from the Ministry of the Economy. Until May 2014, this applied only to public safety, defence and betting industries. May's Decree 2014-479 extends this requirement to any foreign investment affecting the "integrity, security, and continuity of the supply" in the energy, water, and defence industries and in transportation and electronic communication networks.

The point of the decree is presumably to throw up a thicket of political obstacles for potential acquirers, including the commercially crucial element of delay, which can put an acquirer on the back foot while the French political class resolves its concerns and mobilises its formidable

networks. In principle, an acquirer could bet a merger on successfully challenging Paris' legal right in potentia to block it, but Paris will calculate that the decree and the political mood behind it will have a chilling effect on mergers that the government has not pre-endorsed. One French official apparently called the decree a 'nuclear weapon.' Like a nuclear weapon, it is designed to work without being used.

Is Britain trending French on corporate control?

The Alstom case cast an interesting political shadow in the UK, where the British government was facing pressure to take a stronger line on the possible acquisition of AstraZeneca by Pfizer, which collapsed definitively on May 26 when the UK Takeover Panel deadline expired. The AstraZeneca deal was always more likely to die at the hands of shareholders than politicians and not just because the British political class has taken an almost entirely hands-off approach to the market for corporate control for two decades. The AstraZeneca board rebuffed the deal from the start as opportunistic and for failing to fully value its drug pipeline.

Nevertheless, the UK government's stated desire to allow the market to decide was heavily tested by two features of the deal. The first was the central and unabashed role of tax optimisation in Pfizer's calculations, which resonated in London with a latent resentment of corporate tax practice that has been rumbling since the downturn of 2008. The irony is that Pfizer was attempting to take advantage of low tax rates introduced by the Conservative government to make the UK more attractive to foreign investors. The second was the potential impact on the British science and research base. The prospect of Pfizer further hollowing out pharmaceutical research in the UK through global consolidation made the acquisition highly sensitive. Pfizer struggled to make credible commitments to broader stakeholders about jobs and research in the UK and those with concerns used the company's track record - especially in Sweden - against it.

Ultimately, the collapse of the deal in the market excused the government from taking a firmer view or doing more than extracting vague and time limited commitments from Pfizer on its UK operations. The French example of Alstom provided a clear counterpoint for what a greater level of state activism might look like. The UK business secretary, Vince Cable, held open the possibility of reintroducing of a public interest test into UK merger law, in the face of widespread political

pressure, including from within his own Liberal Democrat party. But this would most likely have been a step too far for his Conservative coalition partners.

There is little question that a UK government of a less free market stripe would have found the comparison more politically embarrassing. The Labour opposition said it would have blocked the deal if in power, or at least looked for ways to make Pfizer's job commitments legally binding. There is also little question that at least at the edges the political consensus against intervention in the UK is fraying. At the heart of this is less a question of corporate 'nationality'. Attempts to portray Cadbury as a UK company when it was taken over by Kraft in 2009 did not stack up against its share register and spread of global operations and nobody pretended AstraZeneca was British. Instead, the core concerns are the strength of the UK's value added employment and the nagging anxiety across the political class that Britain struggles to hold onto quality jobs in anything but the financial services sector.

The broad implicit political compact of the last thirty years in the UK has been that the state's investment in education, research and infrastructure that is leveraged by multinationals is indirectly repaid through tax and employment. While this is still holding at a general level, Britain (like the US in many respects) is trending more French in the willingness shown by the government to question the prerogatives of multinationals over jobs, tax and the location of core business activities. There may be limits to this trend, however. Both Peugeot and Alstom deals suggest a willingness by the French government to inject state capital into deals to secure national interests, and a system for doing so, in a way that it would be hard, if not impossible, to imagine the UK doing.

Testing the legal limits of intervention

By some reports, M&A deals in Europe have reached more than half a trillion dollars in the first six months of 2014, more than doubling over 2013 levels. As perceived macroeconomic risk has fallen in Europe and with growing interest in European assets from US and other foreign buyers we can expect both more deals and more political scrutiny. This will be the case especially where deals touch on comparative advantages or sensitive areas of employment - either jobs that are unionised or perceived to be of high economic value, or both.

This is important for corporates who may have been lulled into thinking that the European merger regime has created a one-stop shop for acquisitions clearances and that the formal approvals process in Brussels is what matters above all else. But although the Alstom-GE agreement will now go to Brussels for formal approval, the EU dimension feels more like a coda to a deal that has been made in Paris by the French government.

The basic lesson is that informal approval - by politicians and the stakeholders who influence them - can make, break or shape a deal, with Paris, London and other national capitals each taking their own approach, reflecting local political sensitivities and political cultures. Brussels continues to have an important role in constraining national politicians who may be tempted to test the legal limits of their powers to intervene. But the scope for informal intervention remains wide, and is in part defined by national political instincts. Alstom suggested these instincts are relatively predictable in France; AstraZeneca suggests they may be less so in the UK in future.

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