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# Clients&FriendsMemo

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## WHAT BANKS SHOULD KNOW ABOUT MERGER CONTROL BEFORE TAKING A SECURITY INTEREST OVER A GOING CONCERN

Dear Clients and Friends:

Security interest foreclosure is a rather straightforward process, which banks generally know by the book and believe once triggered should lead to what they are in fact interested in: partial or in some exceptional cases full recovery of outstanding amounts under previously granted loans.

And they are definitely right to believe so, except that, whenever a security interest is placed on assets forming a business going concern[1], banks should look further than that. Since foreclosure implies the transfer of control over a business undertaking, the process itself may require clearance under Law 21/1996 on Competition (specifically, the merger control sections), and the relevant merger control regulations and guidelines issued by the Romanian Competition Council ("**Council**")[2].

As such, banks should look beyond the mechanics of a foreclosure procedure and factor in merger control aspects in order to ensure full compliance with the applicable legislation.

Depending on the foreclosure strategy and underlying objectives pursued by the bank, on the one hand, and the size of the business subject to the security within the relevant market where it operates, on the other hand, the merger control process could prove to be

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[1] Types of bank loan collateral pertinent to our analysis are pledges over shares or general mortgages on the going concern (Rom: *fond de comerț*) i.e. all of the assets that make the business produce value. Mortgages on income generating immovable assets of a special purpose vehicle such as an office building or a shopping mall qualify also for merger control purposes. Banks may also accept a mortgage on stand-alone business assets of a company, e.g., a production facility which is operated as a going concern.

[2] In Romania, the obligation to notify a transaction whereby control is acquired or changed (e.g., from sole to joint control) is automatically triggered above certain turnover thresholds: the acquirer and the target each have at least EUR 4 million turnover in Romania during the financial year preceding the transaction and the acquirer and the target's world-wide combined turnover is at least EUR 10 million. Depending on the international activities and size of the borrower, clearance at the European level could become necessary.

anywhere between a mere time issue and/or a more complex matter involving clearance for the sale of a failed business to a competitor.

***Acquisition by the Banks: Active vs. Passive Ownership***

Banks themselves would in principle not need to obtain merger control clearance upon enforcing a security interest and taking control of the respective collateral, if such control is to be exercised exclusively for purposes of preserving the value of the business with a view to future divestment. However, a bank should inform the Council of the acquisition and the basis for such acquisition, and achieve divestment within one year, a term which the Council may extend upon request.

If a bank would plan to effectively exercise control over the acquired business and take strategic business decisions (for example, by appointing new management, restructuring or downsizing the business, rendering decisions in the way products are marketed, controlling the cash flow, revenues and expenses, etc.), thus affecting the market behavior and position of the acquired undertaking, it would need to obtain merger clearance as if it had acquired control pursuant to a classic transaction.

The same would apply if a bank would decide to sell the business pursuant to a piece-meal process, rather than as a going concern in a one-off transaction, as the result would be the disappearance of the business from the market.

The thin line between passive and active ownership depends on what would be reasonably deemed as necessary to preserve the value of the undertaking and what it would not be necessary.

As banks would generally find it difficult, unusual or contrary to their policies to hold controlling interests over non-financial assets, a *prima facie* conclusion is that banks should not be required to obtain clearance. Nonetheless, if a bank inclines to take aggressive steps to reform a business and prepare it for sale, legal advice should be sought as to whether or not the transaction must be cleared by the Council.

***Enforcement through (followed by) Sale to Third Party Buyer***

Further, banks could be indirectly affected by the merger control timeline and procedure whenever they decide to either (i) privately enforce the security interest and sell the assets (immediately or after a period of passive or active ownership) directly to a third party purchaser, or (ii) an official trustee in bankruptcy attempts to do the same as part of a restructuring process to pull an indebted, still viable business out of insolvency proceedings.

A successful bidder would in any event need to apply for clearance from the Council (if the relevant thresholds would be exceeded), and until a transaction is cleared, the bidder will likely withhold payment of the purchase price owed directly to the bank or *via* the trustee, and this may take several months.

Apart from the time needed to clear a transaction, banks may face another major issue, this time a structural one: if the business offered for sale as a going concern is a leading player in its market, it simply could prove to be too big a fish to swallow. And this would be due to the fact that selling a significant market share operator to a competing business may raise concerns with the Council as to the resulting concentration in the relevant market and its effects on competition. As such, the Council is at liberty to require, in order to clear the transaction, certain behavioral or divestment obligations from the buyer, thus affecting the full sale value of the business.

The hurdles in the process, the significant costs of advisory services and the timeframe involved are all detrimental factors, and if taken together most likely would have an impact on the price sought to be obtained by the bank. As such, unless for example a buyer from outside Romania would greatly desire to enter the market and promptly buy the distressed business in which case merger control becomes only a time issue, a bank would need to plan the process well in advance and assess the timing and costs to be associated with the security interest foreclosure.

***Conclusions***

The interplay between asset foreclosure and the legal requirement to obtain clearance from the Council depends on what a bank wishes to achieve, how actively a bank would intervene in the management of the undertaking, and last but not least the size of the undertaking in the relevant market.

Banks should plan to ascertain in advance how they may most efficiently foreclose the assets at issue and take or transfer control over a borrower, and to what extent merger control issues might affect the value of the respective collateral.

As previously noted, the larger the size of the business subject to a security interest, the closer a bank should scrutinize the relevant merger control issues. As such, a bank should make a merger control assessment, even at the time it is considering extending a loan to a specific borrower, especially if the business offered as security is a going concern and a leading player in its market.

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