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The concept of control under the EU Merger Regulation

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Commission's jurisdiction

Reference texts for jurisdictional issues

- Council Regulation (EC) No 139/2004 – "the Merger Regulation" (Articles 1, 3 and 5)
- Commission Consolidated Jurisdictional Notice of 2008 ("JN")
- Jurisprudence of the General Court and the Court of Justice of the EU

Commission's jurisdiction (2)

When is a transaction caught?

1. **Concentration** (Article 3, Recital 20), i.e. change of control on a lasting basis
    - Merger or acquisition of sole or joint control
    - Intended to relate to operations which bring about a lasting change in the structure of the market

2. Having a **European Union** dimension (Article 1)
    - Depends on turnover generated by the undertakings concerned by the concentration and the geographical allocation of that turnover

What is “control”?

- Wide concept: possibility of exercising "decisive influence" on an undertaking to determine strategic decisions (Article 3(2))
- “Decisive influence”: power to block actions which determine the strategic commercial behavior of an undertaking (para. 62 JN)

Acquisition of Control (1)

1. Who acquires control?
2. How is control acquired?
   - Acquisition of shares or assets
   - On a contractual basis
   - Exceptional: control on a de facto basis
     - attendance rate in general meetings
     - strong economic dependence (e.g. very important supply agreements or credits coupled with structural links)
3. Type of control (sole or joint)
4. Object of control

Object of control

Target – Business with market presence and to which turnover can be attributed

- Whole or parts of one or more undertakings
- Legal entities or assets
- Assets must constitute a business to which a market turnover can be clearly attributed
- Client base, brands or patents can be sufficient, even exclusive licences, if this constitutes a business with a market turnover

NOT: simple outsourcing contracts without asset transfers or if use of assets is limited to provide service to the outsourcing customer

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Joint Control (1)

Situations in which joint control may exist:

- Equality of voting rights or equality of number of members in decision making bodies (50:50 situations)
- Veto rights (details below)
- Joint exercise of voting rights (holding company or pooling)
- Exceptionally: commonality of interest (strong mutual dependency)
- No joint control if casting votes unless vote is of limited relevance

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Joint Control (2)

Veto rights :

- Related to strategic decisions on commercial behavior
  - appointment and removal of management
  - budget
  - business plan
  - investments
  - market specific decisions
- Normal protection of minority shareholders not sufficient, *e.g.* dissolution of company, company restructuring operations, capital increases and decreases
- Assessment in overall context

Lack of sole or joint control

Shifting majorities

Example:

- **3 shareholders (35%, 20%, 45%)**
- **Simple majority voting – any two of the three can team up to win**

Changes in the quality of control

- Concentrations:
  - Entry of new controlling shareholder in a solely controlled undertaking, leading to a change from sole to joint control
  - Entry of new controlling shareholder in a joint venture (one or more additional shareholders or substitution of a controlling shareholder)
  - Reduction in the number of shareholders if this leads to a change from joint to sole control
- No concentration:
  - change from negative to positive (sole) control or vice versa
  - Exit of a controlling shareholder not leading to a change from joint to sole control

Case 1 – sole or joint control?

Google and Facebook decide to buy Apple. They establish a joint venture vehicle which will hold 100% of Apple's shares. Google will own 60% and Facebook 40% of the JV. Google will have the right to appoint the first new CEO of Apple and then that right rotates. Decisions are taken by simple majority except for the budget and business plan which requires a 75% majority. In case of deadlock, a long arbitration procedure is envisaged following which, if no agreement can be found, Google has the right to buy Facebooks's shares in Apple.

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Case 2 – control?

Google acquires a 40% shareholding in a public company called Cloud Computing, Inc. It has no veto rights or any other voting agreement with other shareholders. The rest of the shareholders are widely dispersed. Could Google have sole or joint control over Cloud Computing? How would we find out?

Change of control on lasting basis (1)

- Permanent change of control
- Agreements for a definite period in time with possibility to extend
- Agreements with definite period if period is sufficiently long

Change of control on lasting basis (2)

- Several operations occurring in succession where the first transaction is only transitory in nature

  Different scenarios:

1. Several undertakings jointly acquire the target with the plan to immediately split it up
2. Joint control only for start-up period leading to sole control
3. 'Parking' of a business with an interim buyer (typically a bank)

Case 3 – change of control on a lasting basis?

Google and Facebook decide to buy Apple. They establish a joint venture vehicle which makes the acquisition of Apple's shares. The joint venture agreement provides that Google will then purchase from the JV the mobile phone business of Apple whilst Facebook will take the computer business.

Where is the concentration?

Joint ventures – full functionality (1)

- Criterion to decide whether a joint venture ("JV") falls under the Merger Regulation (full-function) or Article 101 TFEU (non-full-function)
- JV must perform on a lasting basis all functions of an autonomous economic entity:
    - Long duration
    - Independence from parent companies in the long term (relaxed on start-up period, 3 years)
    - Own access to/presence on the market
    - Own management dedicated to day-to-day operations
    - Access to sufficient resources (finance, staff, assets)
- Case-by-case analysis: often finely balanced
    - The devil is in the detail

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Joint ventures – full functionality (2)

- <u>Long-term</u>:
  - ➢ No, if just to construct a piece of infrastructure but no involvement in the operation of infrastructure
  - ➢ No, if necessary uncertain third-party decisions outstanding prior to starting business activity
- <u>Market presence</u>: depends on proportion of goods/services made available to third parties by the JV - considerations:
  - ➢ 50% rule (but some cases where 20% sufficient)
  - ➢ Start-up period (3 years)
  - ➢ Arms-length basis deals with parents
  - ➢ JV may use outlets of the parents if they act as agents
  - ➢ Past accounts/substantiated business plans/general market structure

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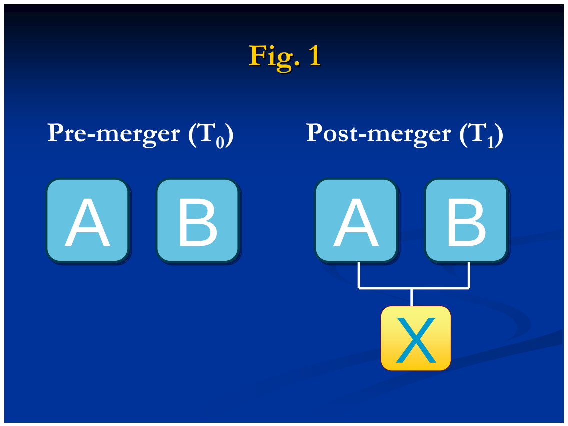
Joint ventures – full functionality (3)

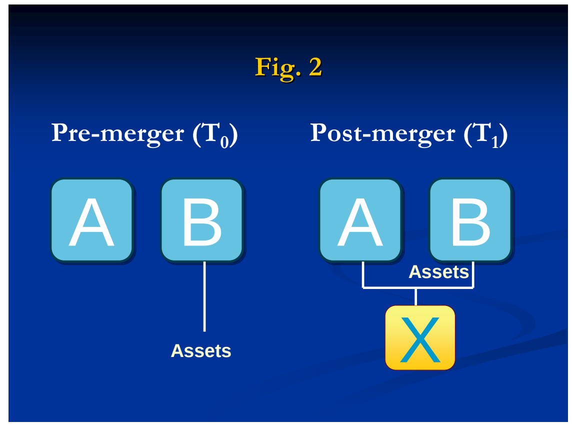
- Purchasing from parents:
  - depends on proportion of goods/services made available to third parties by the JV
  - Considerations:
    - ➢ Start-up period (3 years)
    - ➢ Little value added to the products/services – closer to joint sales agency?

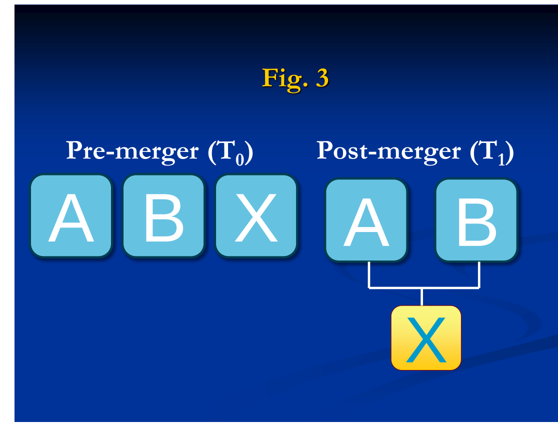
Joint ventures – full functionality (4)

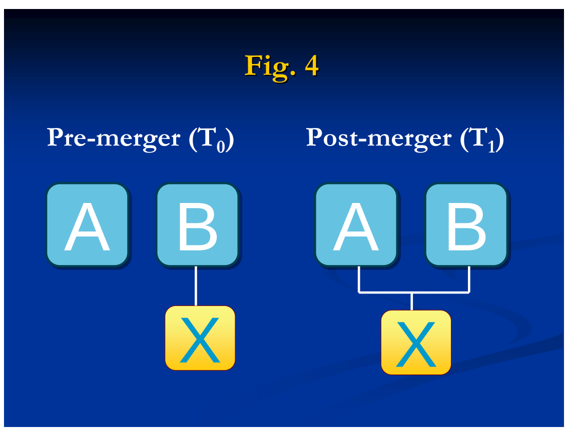
- In principle, **always** necessary to establish that a JV is “full function”
- **One exception**: undertakings acquiring joint control of another undertaking/assets from third parties
- If JV is not full-function, not notifiable – must be thought of as an **"additional"** criteria for JVs to constitute concentrations

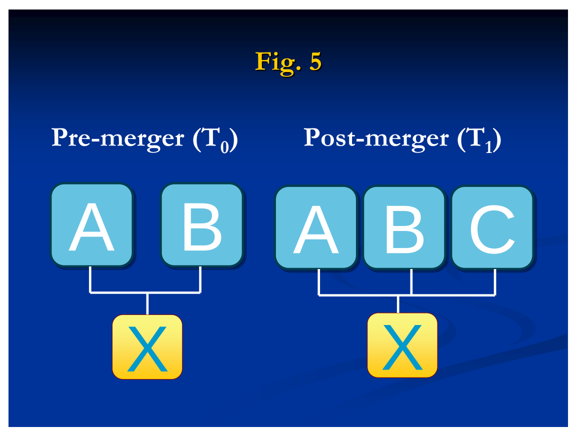
Different operations involving JVs











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Case 4 – Full-function joint venture?

1. Peugeot and Renault decide to establish a joint venture into which they will both put their spare parts manufacturing businesses. They will have joint control over the new entity. The entity will only sell spare parts to the parents. Is this transaction a concentration under the MR?
2. 3 years later the parent companies decide that the JV will also start selling to third parties and the business plans show that they expect 30% of the JVs business to be from third party sales. What happens, if anything?

Interrelated transactions – part of the same concentration?

Interdependent transactions - single concentration, Article 3, Recital 20

Requirements:

- transactions linked by condition or series of acquisitions in securities
- same acquirers (not necessarily the same sellers)

Scenarios: acquisition of a single business, parallel acquisition of control in several businesses, first sole control then joint control

No single concentration if control is not acquired by the same undertakings!

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No concentration

No concentration; Article 3 (5): if control acquired by:

- Credit, financial institutions, insurance companies
  - Holding securities on a temporary basis (<1 year)
  - Limited in exercise of voting rights
- Insolvency administrator
- Financial holding companies: exercising voting rights only to protect full investment