ARNOLD & PORTER (UK) LLP

EU & Competition briefing from Arnold & Porter (UK) LLP
published in the December 2012/January 2013 issue of
The In-House Lawyer:

Proposed changes to the EU merger control regime

Proposed changes to the EU merger control regime

BY TIM FRAZER
partner,
Arnold & Porter (UK) LLP

BY SUSAN HINCHLIFFE
partner,
Arnold & Porter (UK) LLP

IN A RECENT SPEECH ON EU MERGER control, the European commissioner for competition, Joaquin Almunia, identified two areas where he considered changes were required to the current EU merger control regime. First he highlighted his intention to streamline the merger review system to enable the EU Commission to focus on those cases that:

> '... have a real impact on competition and consumers in the internal market, and which require detailed and complex analysis'.

Streamlining the process is intended to reduce the regulatory burden on the merging parties. According to commissioner Almunia, these improvements to the existing EU merger control regime can be introduced relatively quickly and within the current regulatory framework. He anticipates that, after a period of consultation, a final package of amendments to the current rules can be adopted in 2013.

The second proposal is more radical and is intended to address the fact that the current EU merger control rules do not enable the European Commission to review the acquisition of non-controlling minority shareholdings, whether or not they may result in competitive harm. A number of EU countries, including Austria, Germany and the UK, do have merger control regimes that allow the scrutiny of non-controlling minority shareholdings, but this is the exception rather than the norm in European national legal regimes.

In this article we explain the background to the Commission's concerns regarding minority shareholdings and consider what impact this proposed change may have for companies acquiring minority shareholdings.

WHY DOES THE EUROPEAN COMMISSION WANT TO REGULATE THE ACQUISITION OF NON-CONTROLLING MINORITY SHAREHOLDINGS?

The EU Merger Control Regulation (EUMR) applies to 'concentrations'[1]. A transaction is only a concentration if it causes a change in control over an undertaking. A change in control arises when either two (or more) previously independent companies merge, or where one company acquires control over another or in relation to the creation of a joint venture where two or more parties acquire control over a previously independent undertaking[2].

Control is not restricted to majority shareholding; it includes the acquisition of any right that gives rise to the possibility of exercising 'decisive influence' over an undertaking[3]. Under EU merger control rules, therefore, the acquisition of a minority shareholding in an undertaking may result in the acquirer having the possibility of exercising decisive influence over the target. This may arise where, for example, a minority shareholder has the right to appoint more than half the members of the supervisory or administrative board of the target. Alternatively, where the minority shareholder has the right to veto strategic decisions of a company (eg the budget, business plan or the appointment of senior management) this will allow the exercise of decisive influence over that company. In both such cases, the minority shareholder would acquire *de jure* control over the target.

Moreover, de facto control may arise in cases where the shareholder is highly likely to achieve a majority of the votes at shareholders' meetings. In considering whether this is the case, the European Commission takes account of all the following features:

- Whether during the previous three shareholders meetings, ownership of the minority shareholding being acquired would have given the acquirer more than half of the votes cast at the meeting, assuming all the other circumstances of the meeting remain the same[4].
- Whether there is any evidence that, in the future, attendance at shareholders meetings is likely to differ – such that the minority shareholder is more (or less) likely to have more than half of the votes cast. The European Commission may be influenced by any change in the ownership of the remaining shares, or evidence of an increase in the percentage of institutional investors or an increase in investor relations activity.
- The dilution of the other shareholdings, and the number of smaller investors

who would need to change their voting habits to affect the ability of the large minority shareholder to gain more than half of the votes cast at shareholder meetings.

- Whether there are any other structural links between shareholders that might affect their voting patterns.
- Board representation.
- Whether there are any decisions for which a 'super majority' vote is required and the nature of those decisions.
- Whether the minority shareholder has a special position of influence over the other shareholders or the board – for example, because it holds an 'industry leadership' position.

Applying these criteria, the European Commission has decided in previous cases that minority share holdings of between 25.96% and 36.9% can confer de facto sole control over the target. It has not found change of control in any case in which the purchaser acquires less than 25% of shares in the target. However, there is not a bright line threshold and, in at least one, albeit old, case, the Commission has considered whether a company had de facto control through the acquisition of a 21.6% shareholding[5]. The absence of a bright line can catch companies unaware sometimes. For example, the Commission fined the Belgian company Electrabel €20m for failing to notify the acquisition of a minority interest in another electricity producer, which, after a period of years, Electrabel realised had afforded it decisive influence.

Unless the Commission is satisfied that a company has acquired control, it cannot act – even if the acquisition may raise competition concerns. When Ryanair attempted to acquire Aer Lingus by way of a hostile takeover bid, the Commission had no power to prevent the continued ownership of a non-controlling minority shareholding a minority shareholding. Ryanair held 19.16% of the shares of Aer Lingus prior to launching its hostile takeover bid for the company, which it then increased first to 25.17% and then to 29.3%. The Commission prohibited the takeover of the company when Ryanair attempted to acquire a majority interest. However, the Commission was not able to require Ryanair to divest its existing 25.17% shareholding as that shareholding did not confer on Ryanair either legal or de facto control over Aer Lingus.

'The European Commission has decided in previous cases that minority share holdings of between 25.96% and 36.9% can confer de facto sole control over the target.'

The situation is very different in the UK, where the merger control rules allow the competition authorities to scrutinise the acquisition of 'material influence' – a lower threshold than decisive influence. The Office of Fair Trading (OFT) was therefore able to examine the acquisition of the 29.3% shareholding under UK merger control rules. After a legal battle in which Ryanair unsuccessfully challenged the UK's right to examine the transaction on the basis that the challenge was out of time, the OFT referred the acquisition by Ryanair of its shareholding in Aer Lingus to the UK Competition Commission for an in depth review. This is ongoing[6].

As a result of this case, the European Commission has recognised that the EU merger control rules are not well designed to deal with the acquisition of non-controlling minority shareholdings that nevertheless may raise competition concerns. It is this enforcement gap that Almunia's proposals are intended to address.

WHAT IS THE IMPACT OF THE CHANGES LIKELY TO BE?

The application of merger rules to non-controlling minority shareholdings is not new. Such transactions may be captured by US merger rules and, as mentioned above, by the merger control rules of at least three countries in the EU. In Austria and Germany, filing requirements are triggered by a proposed acquisition of 25%[7]. In the UK, the competition authorities have always made it clear that an acquisition of a shareholding of as little as 15% may enable the acquirer to exercise material influence over the policy of the target enterprise, and therefore fall within the jurisdiction of the UK merger control legislation (currently the Enterprise Act 2002).

The OFT has stated that a holding of less than 15%:

> '... might attract scrutiny where other factors indicating the ability to exercise influence over policy are present'[8].

These other factors are similar to those used by the European Commission in looking at the question of control, namely: the distribution and holders of the remaining shares; attendance and voting at shareholders meetings; any special voting rights attached to the minority shares; board representation; supply arrangements or other contracts between the shareholder and the target; and any other special provisions in the memorandum and articles of association of the target.

UK cases in which a shareholding of less than 20% was found to confer material influence on a purchaser are rare. The most recent and the most high-profile example of this was the BSkyB/ITV transaction – when the UK Competition Commission examined whether BSkyB's acquisition of a 17.9% shareholding in ITV would raise concerns. The Competition Commission considered it likely that, with this shareholding, BSkyB would exercise its ability to influence ITV's strategy. This would substantially lessen competition by, for example, influencing ITV's strategy in relation to content production and commissioning, or its investment in high-definition television. As a result of the transaction, there would be a loss of rivalry between BSkyB and ITV in the all-TV market, which would lead to a loss in quality, a reduction in innovation and an increase in the price of services in that market.

Ultimately, it recommended that the secretary of state require BSkyB to reduce its stake in ITV to a level below 7.5%, the level at which the Competition Commission considered would remove any realistic prospect that BSkyB would be able materially to influence ITV's policy[9]. This goes well beyond the current jurisdiction of the European Commission, but is perhaps a good example of the type of decision-making powers that commissioner Almunia would like for the European Commission.

CONCLUSION

The new rules are certain to result in more transactions being notifiable at an EU level and will increase the regulatory burden on companies acquiring minority shareholdings in the future – particularly bearing in mind that the EU system is mandatory but the UK is voluntary. Where the transaction involves competitors, the acquisition of the minority shareholding may be subject to the type of scrutiny (and remedy) that occurred in relation to the BSkyB attempted acquisition of shares in ITV.

Even an initial review by the European Commission can involve significant time and cost. The suggestion from commissioner Almunia is that there will be some kind of selection process in place to ensure that only potentially problematic transactions need be notified. However, it is difficult to envisage how these would be crafted. If a minimum percentage shareholding is used, as in Germany and Austria, the risk is that the enforcement gap will be narrowed rather than closed.

One of the merits of the EU rules is that, other than in relation to the creation of a joint venture where issues can arise around 'full functionality', it is very clear when the EU merger control rules are applicable. If a new concept of control is defined, as a way of selecting only problematic cases, this may create uncertainty in a mandatory filing system. Additionally, although the stated aim of commissioner Almunia is to simplify the EU merger control procedure, history has shown that the inclination of the staff within the Commission is to examine mergers in some detail – even when the current simplified procedure is applicable. It would be natural to expect them to take a cautious approach in applying a new concept of control.

Finally, a change to the EU rules may result in a proliferation of this approach at a national level. Currently, the majority of EU member states have merger control rules that mirror those at an EU-level (albeit with different triggering revenue or market share thresholds). Thus, the concept of control in most member states is currently the same as under the EUMR. Although the changes at an EU level will not automatically be implemented into national rules, it may be expected that at least some EU countries will follow the lead of the Commission.

By Tim Frazer, partner, and Susan Hinchliffe, partner, Arnold & Porter (UK) LLP.
E-mail: Tim.Frazer@aporter.com; Susan.Hinchliffe@aporter.com.

NOTES

1) Article 1 of the EUMR.
2) Article 3(1) of the EUMR.
3) Article 3(2) of the EUMR.
4) Although there are no previous cases on this point, it would appear from the Commission Consolidated Jurisdictional Notice, that if the shareholder as at least 50% of the votes (but not more), this could give them negative de facto control as it would enable them to block votes requiring a majority.
5) See *MAN/Scania* [2006].
6) In another twist in the story, Ryanair has launched another bid to acquire control over Aer Lingus. This is being reviewed currently by the European Commission. The UK Competition Appeals Tribunal allowed the UK Competition Commission to continue its investigation on the basis that the acquisition of the minority shareholding by Ryanair was outside the jurisdiction of the EUMR and therefore there was no conflict between the two investigations.
7) Although in both countries, the acquisition of a smaller percentage shareholding can, in theory, be subject to review if the transaction has the potential to raise concerns.
8) OFT Substantive Guidelines para 2.10.
9) It also recommended that BSkyB be prevented from taking any seats on the board of ITV.

Case No M/336 MAN/Scania (European Commission, 20 December 2006)