Minority Report? The EC’s public consultation on minority shareholdings

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On 25 June 2013, the European Commission launched a public consultation entitled “*Towards more effective EU Merger Control*” in which the Commission proposes to (i) expand its powers to review non-controlling minority interests and (ii) streamline the case referral system between the Commission and NCAs.
The proposals in respect of minority shareholdings will have a profound impact on corporate M&A activities in Europe.

In short, the Commission proposes extending the EU Merger Regulation to catch certain “structural links” – e.g. an acquisition of a minority shareholding that does not confer the ability to exercise decisive influence under the EU Merger Regulation but potentially allows the holder of the interest to exert some “influence” over the target firm with anticompetitive effect.

The Commission puts forward two options:

• Option 1: “the notification system”: this would extend the current system of ex-ante control of concentrations to “structural links”. As a result, any acquisition of a qualifying structural link would have to be notified to the Commission in advance and could not be implemented before the Commission has approved it.

• Option 2: the Commission would have discretion to select cases of structural links to investigate. Two possible variants of this option are proposed:

o “Self-assessment system”: the parties would be required to self-assess the creation of the structural link with applicable EU competition law, but the Commission could decide whether and when to open an ex poste investigation.

o “Transparency system”: the parties to a “prima facie problematic structural link” would have to file a short information notice to the Commission. This notice would be published in order to make third parties and EU Member States aware of the transaction.

Under both the self-assessment system and the transparency system, the Commission asks if the parties to a transaction should have the possibility of making a voluntary notification.

The public consultation comprises a Commission Staff Working Paper and two Annexes (one on the relevant economic literature and one surveying EU and national approaches to structural links). The relevant documents can be found on the Commission’s website at: http://ec.europa.eu/competition/consultations/2013_merger_control/.

The deadline for responses to the public consultation is 20 September 2013.

General remarks

Whilst it may be that in very limited circumstances a structural link may give rise to anticompetitive effects, wholesale legislative reform of the EU Merger Regulation to address such circumstances may result in a highly disproportionate burden on European and international companies doing business in Europe, particularly during these continuingly difficult economic times.

The proposals outlined by the public consultation invariably result in an increase in regulation (even with self-regulation) and potential legal uncertainty for businesses.

Whilst the economic theories outlined in the Annex I to the Commission Staff Working Document are well-recognised, there is insufficient hard evidence that the myriad forms of structural links that exist in Europe have created a critical mass of cases resulting in significant anticompetitive effects justifying a legislative reform of the EU Merger Regulation.

The Staff Working Document appears to acknowledge this: “*as the number of cases creating problematic structural links seems to be rather limited, it may be doubted whether it is necessary to apply all the procedural rules of the current merger regulation to structural links…*“.

This public consultation is in stark contrast to the modernisation efforts of the Commission over the last 25 years, in which the European competition law reforms have aimed at more efficient and effective procedures in ways that have benefitted businesses as well as ensuring the protection of competition principles (e.g. the creation of one-stop shop merger control, self-assessment for agreements, decisions and practices, a more effects-based approach, the merger referral mechanisms, the merger simplification procedure, etc).

Indeed, the Commission itself (on launching the Merger Simplification Project) announced: “*The proposal aims to make EU merger control even more business-friendly by cutting red tape and streamlining procedures. This initiative is part of the Commission’s overall effort to make administrative procedures less burdensome for business, thereby stimulating growth and making Europe more competitive*“. This public consultation on structural links appears to fly directly in the face of such intentions.

Structural links typically (though not always) arise from minority shareholdings. Equity shareholdings below a level that confer decisive influence are an essential part of the European economy. Not only do they allow access to important sources of capital for target companies in times when liquidity and external funding sources are scarce, but they also provide important investment opportunities and risk mitigation options for financial and trade investors. Often, a minority shareholding may be one of the first steps in the courtship between two companies that may result in a formal public offer or a takeover bid (which would be reviewable under the EU Merger Regulation or Member State national merger control laws).

There may be a very real risk to these general economic benefits as a result of such a fundamental change to the EU Merger Regulation. Put simply, European target companies (or companies having significant activities in Europe) will be significantly less attractive investments than those elsewhere. Similarly, European companies looking to invest may be forced to consider investments elsewhere (which may entail greater investment risks for them). The proposals are likely to have wide-reaching commercial and economic effects that are likely to impact on the health of the European economy and its route back to recovery.

The proposals in respect of structural links should be dropped in their entirety.

It is not appropriate to extend the Commission’s powers to investigate the creation of structural links under the EU Merger Regulation

A review of EU merger control policy should follow any significant EU merger case that raises fundamental points of competition law policy, such as *Ryanair/Aer Lingus*.

However, the structural link proposals would be a “kneejerk” reaction to the issues that arose on the specifics of one single case, with a disproportionate impact on the wider M&A markets in Europe.

Putting economic theory to one side for a moment, there does not appear to be a significant trend in structural link cases that demands action. Annex II to the Staff Working Paper itself states “*at least 53 merger cases have been identified from 1990 where structural links were relevant for the competitive assessment of the transactions…structural links were found to create competition problems in at least 20 of these cases*“. This represents a Commission intervention rate of approximately **0.37%** of all notified cases up to 31 July 2013.

Obviously, those cases related only to circumstances in which a pre-existing structural link was involved. Nevertheless, even had the EU Merger Regulation covered acquisitions of structural links identified in the Zephyr database (see Annex II), there is absolutely no evidence in the public consultation that there is a critical mass of cases resulting in anticompetitive outcomes or that the incidence of Commission intervention in such cases would have been higher.

The Commission “*has the tools*” to address problematic cases of structural links:

• pre-existing structural links can be reviewed under the EU Merger Regulation in the review of subsequent concentrations (given the creation of additional horizontal, vertical or conglomerate overlaps) as was illustrated in the cases of *Glencore/Xstrata, IPIC/MAN Ferrostaal, Toshiba/Westinghouse, E.ON/MOL, Siemens/VA Tech, Alcatel/Telettra*, et al (that is also to say that any structural link is in any event likely to be subject to scrutiny at a later point in time if not upon its acquisition);

• pre-existing structural links that evolve into de jure or de facto control are already caught by the EU Merger Regulation (as is clearly set out in paragraphs 56-60 of the Commission’s Consolidated Jurisdictional Notice);

• the creation of structural links not caught by the EU Merger Regulation or national merger control may yet fall to be reviewed under Article 101 and 102 TFEU.

This latter point was clearly confirmed by the President of the General Court Judge Marc Jaeger in the Order relating to the application for interim measures by Aer Lingus “*as far as the existence of a regulatory lacunae is concerned, it should be pointed out that, whilst a minority shareholding of the type in question cannot, prima facie, be regulated under the [EU Merger] Regulation, it might be envisaged that the EC Treaty provisions on competition, and in particular Article 81 EC and Article 82 EC, can be applied by the Commission to the conduct of the undertakings involved following the acquisition of the minority shareholding*“.

Structural links involving shareholder agreements and other contracts are likely to provide the legal basis on which an Article 101 TFEU decision can be made. It is true however – as Jaeger J pointed out – that a structural link may arise in circumstances in which “*the necessary meeting of minds might be difficult to establish*” under Article 101 TFEU, but this does not prevent the application of Article 102 TFEU where dominance can be found.

Indeed, in the two other case examples used in Annex II to the Staff Working Paper to illustrate the kind of potential competition issues raised by structural links cases (*LVMH/Hermès* and *Salini Construttori/Impregilo*), the Commission itself describes LMVH as “*the world’s biggest luxury group*” and Impregilo as “*Italy’s leading engineering and general contracting company in civil construction*“. Whether or not a finding of dominance could be upheld in either of these individual cases is not the point (in fact there has been no investigation into either of these situations). The point is that the types of structural link transactions which the Commission appears most concerned with are those that are “*economically significant*“. In such cases, it is more likely that the Commission (using its “plausible markets” approach) will be able to make a finding of dominance, even below the level at which dominance may be presumed at 50% (e.g. *British Airways* at 39.7%).

It is questionable whether anticompetitive concerns are likely to arise in cases where Articles 101 and 102 TFEU cannot be applied (but if this is possible in practice it is likely to be limited to a handful of cases).

In short, it is not appropriate to extend the ambit of the EU Merger Regulation to control for the acquisition of structural links. A number of the reasons why this is the case are set out below.

On the need for the competition law agencies to be “kept informed”

The Commission and the Member States are sufficiently well-resourced and well-informed about transactions in the market. It is well understood the competition law agencies in Europe actively monitor the general and business press.

The Commission’s own Zephyr database itself (albeit ostensibly only an analysis for the purpose of the public consultation) demonstrates that the Commission has sufficient resources to monitor transactions in the

market.

Indeed, prior to the introduction of the EU Merger Regulation in 1990, the Commission regularly monitored and reported on transactions involving minority shareholdings in its Annual Report on Competition Policy.

At the same time, all companies in any industry are generally highly-aware of the transactions taking place involving their competitors, customers and suppliers (even if in markets further upstream or downstream).

Therefore, the "*need to be informed*" is not a highly relevant consideration.

On the administrative burdens for companies

The proposals would result in a considerable administrative burden on companies. In particular:

• "Notification System": it is already well-understood that the existing EU Merger Regulation notification system imposes a very considerable burden on notifying parties (in terms of timing, legal and economic costs, senior management and internal legal time and other resources). Extending the merger notification requirements to minority shareholdings would be highly disproportionate to the potential anticompetitive problems that the Commission has identified and would inevitably result in many acquirers simply opting not to invest at all if they face the costs and timing issues of a merger filing. In addition, such costs and burdens would also be imposed on the target companies – in respect of transactions in which they may or may not have any involvement (e.g. stock market transactions).

• "Self-assessment System": whilst this does appear to involve a lesser administrative burden for the parties, this would introduce a greater legal uncertainty around investments in minority shareholdings. Whilst it is true that such investments today (pursuant to the application of Article 101 TFEU) are already subject to self-assessment, this risk is generally perceived as being low-risk if not hypothetical (except in exceptional circumstances). To introduce into the EU Merger Regulation a self-assessment system – akin to the voluntary system under the UK Enterprise Act – in which such investments are potentially at risk of greater post-closing investigation and enforcement action would increase the legal uncertainties of doing business in Europe. This would result inevitably in greater business costs in the additional evaluation of such investments, and decrease the attractiveness of European equity or equity engaged in significant European activities.

• "Transparency System": again, whilst this system is less of an administrative burden that the Notification System, companies doing business in Europe today are already significantly burdened by red-tape and regulation. Even a "*short information notice*" is an unwelcome additional burden on the desks of the extremely busy people in the legal departments of clients. Whilst it may be possible to complete such forms within a reasonable period of time, it is inevitable that external counsel will be instructed for such transactions. Accordingly, this system will increase the administrative burdens placed on companies.

Furthermore, the overall volume of transactions involving structural links is likely to be considerably higher than the numbers indicated in the Zephyr database. The main findings of the analysis of that database indicate that there were only 91 transactions during the seven years from 2005-2011 "*potentially meriting competition scrutiny*". This equates to roughly **13** transactions a year – implying an insignificant incremental administrative burden for companies operating in Europe.

However, the analysis was based on data drawn with a certain methodology:

• transactions (presumably including structural links cases) at EU national competition authorities were excluded from the sample;

• non-horizontal transactions were excluded from the sample;

• a certain number of proxies were applied in order to exclude scenarios of de facto control (and it may have been that certain transactions not conferring de facto control were mistakenly excluded in this process).

The number of likely transactions caught by the proposals of the Commission is likely to be very considerably higher than just 13. In the Commission's 19th Report on Competition Policy published in 1989 (reporting on competition developments in the years prior to the EU Merger Regulation coming into effect), the number of national, community and international transactions involving minority shareholdings for 1988/1989 was **273**.

This statistic was based on "*data gathered by the Commission from the specialist press*". Naturally, economic cycles fluctuate, but if the Commission found 273 relevant cases in only one year of structural links using 1989 technologies, it is likely that the number of structural links cases will be higher today. Whilst many of these cases may not trigger the EU Merger Regulation turnover thresholds, the additional number of notifiable cases is likely to be significantly higher than the 13 cases per year implied by the Zephyr analysis.

In particular, the Zephyr database analysis explicitly excluded "*financial investors*" and "*acquisitions of shareholdings considered to be purely risk diversification investments*". There does not appear to be a similar exemption from the proposals for these types of transactions.
The administrative burden on the European economy is likely to be far greater than that implied by the Staff Working Document.

On the potential harm to competition

The Working Staff Paper and its Annexes set out the economic theories and cases involving pre-emptive enforcement action in respect of structural links. But they do not provide any hard evidence to establish (employing an effects based approach) that there is a critical mass of structural links case that have actually resulted in anticompetitive harm.

It is clear that economic theory demonstrates that such harm is potentially possible. The formulation of the EU Merger Regulation is such that it attaches to the potential as well as the actual effects of a concentration. Accordingly, the prior decisional practice of the Commission in the cases outlined in Annex II was arguably an appropriate application of the EU Merger Regulation.

In all of the EU cases listed by the Commission, the remedies were apparently offered up based on the serious doubts or competition concerns that the Commission had in relation to potential effects. Yet, in not a single case was the concern of the Commission challenged by the parties before the European Court of Justice (which is obviously the final arbiter on matters of EU merger control in Europe). However, in one of the German cases listed in Annex II (*DuMont Schauberg/Bonner Zeitungsdruckerei*), the parties prevailed before the Court of Appeal in Dusseldorf. The Court annulled the prohibition, finding that a competitively significant influence did not result from the structural link created by the transaction. The withdrawal of the referral in the Austrian *Hermann Thiele/Vossloh* case also resulted in the transaction being approved.

The Staff Working Paper concludes "*the Commission's and the Member States' practice shows that structural links can result in significant harm to competition*". It then refers to the *Ryanair/Aer Lingus* matter – yet that matter is still pending final determination by the UK Competition Commission (having being referred by the UK OFT on 15 June 2012).

The UK Competition Commission's provisional findings were published on 3 June 2013; I do not comment on this case as it is still pending, but would note that any final decision by the UK Competition Commission will of course be judicially reviewable before the CAT (and the UK Supreme Court), if a resolution through remedies is not achieved first.

Any prospective EU Merger Regulation analysis of the creation of a structural link could lead to remedies being imposed without the need for the actual effects of any potential harm being demonstrated. If the present substantive test is retained for structural links, it will only be sufficient for the Commission to demonstrate that a structural link may significantly impede effective competition without necessarily proving that it will result in anticompetitive harm. If an analogy with Article 101 TFEU may be permitted, this is potentially akin to a *restriction by object* (which of course obviates the need for the Commission to assess whether the specific agreement or clause has the effect of restricting competition). The burden would automatically swing on to the party acquiring the structural link to demonstrate that such effects will not arise.

This would appear to be an onerous legal imposition on transactions that were previously not caught by the EU Merger Regulation and that do not result in an acquisition of control.

Annex I to the Staff Working Document surveys the economic literature and itself illustrates that the competition concerns arising from structural links are not as clear, precise and quantifiable as those from outright acquisitions of control. The language used is sometimes conditional and speculative (e.g. "*may increase firm's incentives…the effects may materialize…the unilateral effects of the acquisition of structural links are typically of a significantly lower magnitude than in a full merger…structural links generally have an ambiguous impact on firms' incentives to sustain coordination…the level of influence may be difficult to assess in practice…structural links may lead to a relatively large price increase if the acquisition of a minority stake confers significant corporate rights to the acquirer which may already be covered by the existing merger regulation*", etc). The key point is that – whilst the economic theory may be sound – there is a material risk that the specific circumstances of any given case will be difficult to assess in practice (look at the length of the UK CC's review of *Ryanair*).

It is interesting to note the *obiter dicta* in the Order of Jaeger J in Aer Lingus when considering whether the criteria for urgency was met. Jaeger J considered whether Aer Lingus could demonstrate that it would suffer damage that was "*foreseeable with a sufficient degree of probability*" (note this language is almost identical to the language used by the European Court of Justice in *Kali und Salz*). The Judge went on to opine that Aer Lingus had in a number of respects failed to demonstrate with sufficiently concrete evidence the harm that was alleged to be at stake, the likelihood of such harm occurring and whether such harm was serious (and irreparable): "*it follows that the assertions put forward by the applicant remain hypothetical and unsubstantiated statements which do not satisfy the condition of foreseeability of harm with the requisite degree of probability*". Jaeger J's *obiter dicta* is echoed in the General Court's judgment.

Given the increased difficulties of assessing whether a structural link will in fact give rise to actual or potential anticompetitive harm, particularly under the tight statutory timetable of the EU Merger Regulation, there is an increased risk of **Type I errors** arising from a procedure that requires the mandatory notification of structural links. This is particularly the case given that the types of economic and legal analysis required to assess whether a structural link gives rise to antitrust concerns are complex and difficult, if not highly subjective and speculative.

Such a perceived risk would contribute to the overall risk profile of companies making financial investments by way of minority shareholdings, thereby making them less commercially attractive.

Given this material risk of "*over-enforcement*", the cost-benefit analysis of reform to the EU Merger Regulation is not warranted.

The proposals raise other technical and philosophical questions

On a technical point, if the notification system is applied to structural links, it is not entirely clear as to how the EU Merger Regulation turnover thresholds would be applied for the target company (e.g. would 100% of the turnover be taken into account or only pro rate in proportion to the level of shareholding being acquired?).

In addition, if any of the proposals are adopted by the Commission, this would arguably result in Commission competence arising over structural links – matters over which the very large majority of Member States do not have jurisdiction (with the exception of Austria, Germany and the UK).

This risks creating an even larger enforcement "gap" than exists currently, raising further questions. For example:

• Would Member States thus be encouraged to amend their own merger control rules so as to bring them into line with the EU Merger Regulation to cover structural links?

• Would Member States be able to request a referral back of an acquisition of a structural link notified to the Commission even though the Member State's own merger control law does not attach to structural links?

Clear, precise, easy to apply and generous safeguards

If the EU Merger Regulation is extended to cover structural links, the safe harbours should be well-defined,

clear and precise, and easy to apply, and sufficiently generous so as to focus regulatory attention on those types of structural links transactions that are most likely to result in harm.

Suggestions for safe harbours might include:

(a) structural links arising outside of equity shareholdings are excluded (so structural links arising from debt or securities or from supply agreements are not caught);
(b) minority shareholdings in companies in unrelated markets (whether horizontal, vertical or conglomerate) are excluded;
(c) minority shareholdings by "financial investors" are excluded – even if the financial investor has other portfolio companies in related markets (as the structural link is not "direct");
(d) minority shareholdings below 15% are excluded;
(e) minority shareholdings below 25% are excluded if the resulting shareholding is not the largest single shareholding in the target company or the shareholding does not grant a right of access to any confidential information of the target company;
(f) minority shareholdings below 25% are excluded if the target company does not have a Special Resolution mechanism requiring 75% or more votes for approval for material commercial matters (i.e. going beyond decisions related to the "essence" of the company or joint venture such as changes in the statute, increases/decreases in capital or liquidation/winding up) such as non-ordinary course transactions;
(g) minority shareholdings below 25% are excluded if the combined horizontal market share of the acquirer and the target company is below 30% or the individual market shares of the acquirer or the target company in any vertically related market is below 30%.

Any ex poste review should be subject to a limitation period after which it can no longer investigate/intervene against a structural link transaction

It is absolutely essential for any regime that involves an ex poste review of structural links to include a limitation period. Disproportionate legal uncertainty will reign if this is not the case.

The UK Enterprise Act 2002 provides a strict limitation period under the UK merger control regime of four months from the UK OFT becoming aware of a transaction, and this has proven to work in practice.

Given (as noted above) that the Commission and national competition authorities are well-resourced and well-informed, a similar period (e.g. three or four months) from the date of the completion of the acquisition of the structural link should be strictly applied if the self-assessment or transparency systems are adopted.

Concluding remarks (if you are still with me)

In the 2002 science-fiction film "Minority Report" set in the year 2054, Tom Cruise plays an elite detective whose "Pre-Crime" system uses the images of clairvoyants' visions to see into the future and intervene in serious crimes before they actually take place. However, only the names of the victim and perpetrator, and the time and date of the crime, are explicitly given. Yet, the Pre-Crime system is deemed flawless. Many go to prison. Cruise's character discovers however a "minority report" of one of the clairvoyants; this reveals that the Pre-Crime system is flawed and that alternative outcomes are possible. The perpetrators imprisoned using Pre-Crime are eventually pardoned. It's a good film.

Even if you don't like Tom Cruise or his films, it is tempting to see a loose analogy here with pre-emptive merger control in general but particularly on the assessment of the complex circumstances surrounding structural links.

I don't believe there is any intention to make a "Minority Report II". Some say that certain things are better left alone.