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UK Merger Control: An Expansive Approach to Jurisdiction

David Riley (Kirkland & Ellis) · Tuesday, November 5th, 2019

In his letter to Government[1] from February this year, the Chairman of the UK Competition and Markets Authority ("CMA") proposed the introduction of a mandatory and suspensory notification regime in the UK for "larger mergers". The adoption of this proposal would result in the creation of a hybrid regime in the UK, with the notification of mergers not falling into this category remaining voluntary, with no obligation to delay closing.

Dissenting voices have questioned the workability of dual-regime, but accepted that perhaps the time is right for a change. Many are of the view that the transition to a mandatory, suspensory filing regime applicable to all mergers is the most appropriate course of action and the best way to ensure predictability for business.

The possibility of such a move raises questions about the appropriateness, within a mandatory regime, of certain elements of the current test for establishing jurisdiction under the UK Enterprise Act 2002 ("the **Act**") – specifically (i) the share of supply test under Section 23 of the Act; and (ii) the concept of "material influence", introduced by Section 26 of the Act. Proponents of change argue that, within a mandatory regime, these concepts risk undermining legal certainty and increasing complexity for business.

Whatever the view of industry about their role going forward, 2019 has been a year where the CMA has shown a clear willingness to utilise the flexibility inherent in both these concepts for the purposes of establishing jurisdiction. This serves as a reminder that merging parties (and minority investors) considering the CMA's jurisdiction to review a transaction – in particular where horizontal and/or vertical overlaps exist – should be sure to do their homework. A brief summary of two important cases is provided below.

1. **Anticipated acquisition by Sabre Corporation of Farelogix Inc[2]**

The anticipated acquisition was not initially notified to the CMA by the merging parties, but identified as warranting investigation by the CMA's mergers intelligence function. On 27 September, the CMA published its full decision on reference under section 33(1) of the Act and has now referred the transaction for a Phase II

investigation.

According to the CMA's decision on reference, Sabre and Farelogix both supply services that facilitate the indirect distribution of airline content. Sabre supplies these services through its global distribution system (GDS), which collects and aggregates information from airlines and other third parties and distributes offers to travel agents. Farelogix supplies these services through a product that allows airlines to connect to travel agents directly.

The CMA established jurisdiction over the anticipated acquisition on the basis of the share of supply test having been met, on two separate grounds:

- **Ground One**: the parties' combined share of supply to a single customer, British Airways

The CMA makes the point that British Airways' bookings accounted for more than [70-80]% of all bookings made with UK carriers through the three largest GDSs (Amadeus, Sabre and Travelport), indicating that bookings by British Airways represent a substantial portion of all UK airline bookings. Additionally, as the flag carrier airline of the United Kingdom, the CMA considered that British Airways' procurement choices are liable to have a material impact on UK consumers.

- **Ground Two**: the parties' supply of services to travel agents in the UK

Contesting the CMA's interpretation of the test, the merging parties emphasise that, whilst Sabre does sell direct to travel agents in the UK, Farelogix has no travel agent customers and no revenue at all in the UK – see the parties' initial submission[3]. However, in considering the share of supply test to be met, the CMA emphasises what it considers to be "two-sided features" inherent in the supply of services to facilitate the indirect distribution of airline content. In the CMA's view, these two-sided features mean that Farelogix's product has to meet the needs of both sides of the market, including those of travel agents based in the UK, which do not pay directly for Farelogix's services.

The CMA's jurisdiction continues to be contested by the merging parties. However, the approach so far adopted by the CMA suggests that, when assessing whether transactions might trigger a voluntary filing under the UK share of supply test, merging parties may wish to consider:

1. not only whether there is a relevant sub-segment of customers to which the 25% share of supply threshold should be applied, but whether any individual customer has certain characteristics which might justify a similar approach being taken (e.g., customers with a regional monopsony or UK "flag carriers" in other industries with a significant downstream market share); and
2. even where one of the merging parties has no direct sales to (or contractual relationships with) customers based in the UK, whether the market has any "*two-sided features*" which mean the CMA might apply the share of supply test to a separate, related market with a UK nexus. Significantly, it is not clear that the CMA considers this approach to require the operation of a two-sided platform as such. Rather, the existence of "*two-sided features*" might justify such an approach.

The approach adopted in Sabre/Farelogix perhaps reflects the CMA's intention to use the flexibility inherent in the share of supply test to review mergers which it considers have the potential to impact consumers in the UK, in particular in digital markets. It should be remembered that the wording of Section 23 of the Act allows the CMA to apply a number of different criteria in assessing whether a share of supply of 25% arises, including "*value, cost, price, quantity, capacity, number of workers employed or some other criterion, of whatever nature.*"

In this context, it is worth noting that the CMA has retrospectively considered its jurisdiction over a number of historic high-value non-horizontal digital mergers, at the request of the Digital Competition Expert Panel. According to the Panel's final report for Government[4], the CMA assured the Panel that in each case it could have asserted jurisdiction through the share of supply test, which it emphasised "*is characterised by a considerable degree of flexibility in practice*". Based on the CMA's input, the Expert Panel reported that "*there is not currently a strong case for any legislative change to the CMA's jurisdiction*" for the purposes of addressing concerns in digital markets.

2. **Anticipated acquisition by RWE AG of a 16.67% minority stake in E.On SE[5]**

Under Section 26 of the Act, a minority investment may give rise to a relevant merger situation (and "*enterprises ceasing to be distinct*"), where it affords the acquirer the ability to exercise "*material influence*" over the target.

According to the CMA's guidelines, a shareholding of 25% or more would usually give rise to the presumption of material influence given the nature of the decisions that will typically require a special resolution. For acquisitions of shareholdings below 25%, no such presumption arises.

Prior to RWE/E.ON, the lowest shareholding deemed to have conferred decisive influence under Section 26 of the Act was the acquisition by British Sky Broadcasting Group plc of a 17.9% stake in ITV plc.

As in Sabre/Farelogix, the CMA's jurisdictional assessment was contested by the Parties. In their view, the minority investment could not confer decisive influence on RWE for the following reasons:

1. the minority stake was intended to be a purely financial investment;
2. an investor relationship agreement had been put in place which limited RWE's ability to exercise material influence over E.On; and
3. RWE's expertise would not afford any degree of "soft" influence over other shareholders.

The CMA disagreed with the parties' view. Instead, it considered that RWE's likely influence over other shareholders might be sufficient to confer material influence for the following reasons:

1. RWE would be by far the largest shareholder in E.On (with a stake more than twice

that of BlackRock, the second largest shareholder with 7%); and
2. RWE's industry status and expertise might enable it to influence the views of other shareholders in relation to decisions favoured by E.On's board.

The CMA did not consider the investor relationship agreement or the stated intention of the investment as purely financial to preclude the possibility of material influence.

The approach taken by the CMA acts as a reminder that shareholdings below 25%, in particular when being taken in competitors, entities active at different levels of the supply chain or related markets, might give rise to a relevant merger situation in the UK. In RWE/E.On, the CMA stressed that RWE had previously been a competitor of E.ON and that it continued to be active in energy sector related activities, associations and conferences.

The CMA's guidance sets out that it may examine any shareholding of 15% or more in order to determine whether the shareholder might be able materially to influence company policy. However, the CMA's approach in RWE/E.On suggests that where the investor is another industry participant, consideration should be given to whether factors exist which might still give rise to material influence, even for shareholdings below 15%.

As regards institutional investors building up a material shareholding in a single business, or a number of businesses in the same industry, the CMA's decision offers some comfort that equivalent shareholdings might be less likely to be deemed to confer material influence. In the context of RWE/E.On, the CMA's view was that institutional investors "*do not have the same level of expertise and active involvement in the industry as a former competitor of RWE*".

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[1] CMA, Letter from Andrew Tyrie to the Secretary of State for Business, Energy and Industrial Strategy, February 2019.

[2] CMA, *Anticipated acquisition of by Sabre Corporation of Farelogix Inc, Decision on relevant merger situation and substantial lessening of competition*, 16 August 2019.

[3] Initial Phase II Submission, Sabre Corporation/ Farelogix Inc., 19 September 2019.

[4] Report of the Digital Competition Expert Panel, Unlocking digital competition, March 2019.

[5] CMA, *Anticipated Acquisition by RWE of a 16.67% minority stake in E.On SE, Decision on relevant merger situation and substantial lessening of competition*, 5 April 2019.

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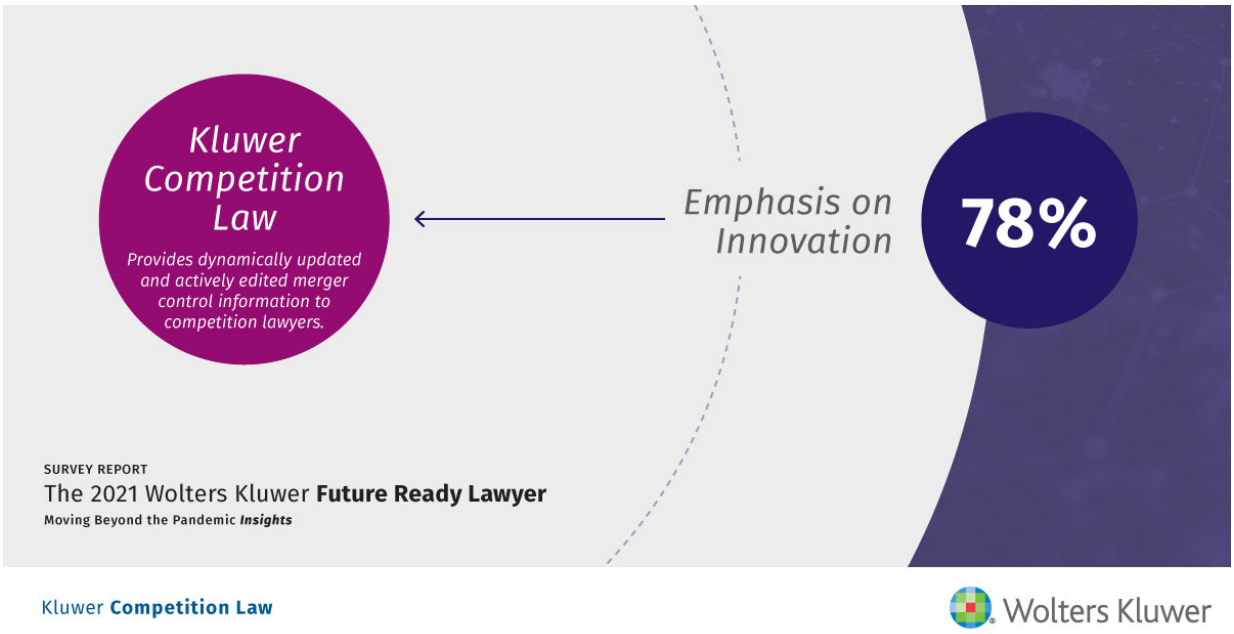

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