Dealing with mergers

There are new Commission guidelines on jurisdiction and remedies

*by **Catriona Hatton****

The Commission adopted a jurisdictional notice on the control of concentrations (the Notice) in July 2007. It is also currently in the process of finalising a notice on merger remedies (the draft Notice), which was published in draft form in April 2007. This article looks at the Notice and draft Notice, and their impact on the scope of the Commission's jurisdiction to review mergers under the EU Merger Control Regulation and the treatment of remedies in merger cases. These initiatives are not new law. Rather, they are designed to set out guidance based on the Commission's experience in the mergers it has assessed to date and to reflect changes brought about by European Court case law and by the new Merger Regulation which came into force in 2004.

Jurisdictional notice on the control of concentrations

The Notice consolidates and updates previous notices. Among other things, it deals with the types of transactions which will be considered as mergers, including when a joint venture or an outsourcing arrangement will be regarded as a merger and what revenues need to be taken into account in determining whether EU thresholds have been met. The second issue can be complex in cases where acquisitions are made by joint ventures or consortia, or by investment funds.

Key points covered in the Notice include the following:

■ **Notification**. Certain changes in the scope of pre-existing joint ventures are notifiable. These include where parent companies transfer to the joint venture additional assets, contracts, knowhow or other rights which provide the basis for the joint venture to extend its activities in the market. Furthermore a change in the organisational structure of a joint venture may trigger a notification if, for example, the joint venture previously supplied goods or services only to its parents but it then takes on a market-facing role. The notification obligation would arise once the parents take the decision to make the organisational changes, and approval needs to be obtained before such changes are implemented.

■ **Challenges for investors**. The Notice also highlights the specific challenges faced by private equity firms and other investors, who may need to monitor a multitude of investments in companies and joint venture projects. They must identify the point at which a notifiable EU merger arises – for example, as a result of creeping changes in the control of one of their investments or significant changes in its activities or to its assets. This can be a particular challenge in the case of joint ventures where, as noted above, an EU merger filing can be triggered by the transfer of additional assets to a pre-existing joint venture or the joint venture gaining more autonomy from its parent companies.

■ **Antitrust warehousing**. The Commission has in the past identified "antitrust warehousing" as an area of concern. The particular warehousing situation which the Commission is concerned with is where the target is acquired by an intermediate buyer, usually a bank, on behalf of the ultimate buyer. The target is "parked" with the intermediate buyer, pending antitrust approval of the ultimate acquisition, and the seller may be paid regardless of whether EU approval is granted for the final transaction.

This two-step process is sometimes used in transactions involving significant antitrust issues, so that the antitrust risk of the transaction is removed from the seller. The Commission does not favour such structures, as indicated in its review of Vivendi/BMG Publishing in 2006. Under the new Notice, the Commission indicates that it will consider this two-step structure as a single acquisition. In those circumstances, the transfer of the assets to the bank can be viewed as a first step in the implementation of the sale to the ultimate purchaser and, if so, the assets cannot be transferred to the bank without the Commission's approval of the acquisition by the ultimate purchaser. This interpretation by the Commission of the nature of such transactions will limit the use of warehousing arrangements as a means of transferring antitrust risk away from the seller.

■ **Outsourcing guidance**. For the first time, the Commission provides specific guidance on outsourcing arrangements. The Notice underlines that outsourcing deals (for instance, where a company outsources IT services) can trigger an EU merger filing. This is particularly likely where the associated assets and/or personnel transferred to the outsourcing service supplier enable the service supplier to provide services not only to the customer that has outsourced its business but also to other customers. Therefore, even if the in-house business to be transferred did not serve third parties, provided the assets and/or personnel transferred allow the service supplier to build up a market presence "within a short period of time", the transaction will require prior approval under the EU Merger Regulation if thresholds are met. This assessment is not self-evident in all cases and may involve second-guessing possible evolution of the market and forecasts for the particular business concerned.

■ **Licences.** In the Notice, the Commission confirms that even a long-term exclusive licence may amount to a notifiable merger. A transaction which is confined to intangible assets such as the transfer of brands, patents or copyrights can trigger an EU filing, provided the assets constitute a business that generates market turnover. However, if the licences are transferred without additional assets, the transaction will trigger a notification only if the licences are exclusive. The exclusivity does not necessarily have to be worldwide or even EU-wide. The Commission notes that a licence may constitute a notifiable merger if it is exclusive "at least in a certain territory".

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■ **Acquisition of control**. Guidance is provided on how the Commission will assess the acquisition of control by investment funds in terms of whether the investors themselves, the investment company and/or the different funds established by the investment company and/or their portfolio companies can be considered under common control. This will have an impact on both the revenues to be taken into account in determining whether such acquisitions meet the EU merger thresholds and the substantive assessment of the acquisition.

Draft remedies notice

In April this year, the Commission published for comment a draft notice on remedies which would replace the existing notice published in 2001. This initiative is prompted by the results of a study on remedies which the Commission published in 2005 and by recent European Court case law.

The Commission's study on remedies assessed the effectiveness of merger remedies accepted in 40 merger cases approved between 1996 and 2000. The results of the study suggested that the non-divestiture remedies accepted by the Commission were not effective in addressing the antitrust issues in most cases that were assessed. For example, in some instances, the Commission accepted remedies such as termination of exclusive rights or granting access to key infrastructure or technology. However, while sale of part of the overlapping businesses to an effective potential competitor remained the Commission's preferred remedy, the study also identified a number of problems with the implementation of divestiture remedies.

In the meantime, in the *Tetra Laval Sidel* case, the European Court of Justice upheld the decision of the Court of First Instance in confirming that commitments relating to merged entities' future conduct – known as "behavioural commitments" – may (in certain instances) be an adequate or even the only possible remedy. In that case, the Commission had rejected Tetra Laval's commitment not to leverage its strong market position in carton into plastic packaging, considering that such behavioural commitments were generally insufficient to address antitrust issues raised by a merger.

Based on all of these developments and more recent Commission decisions in which remedies were accepted, it was timely for the Commission to revise its 2001 remedies notice. The draft Notice provides guidance on a range of issues relating to proposed remedies, including the nature and scope of the appropriate remedy, the identification of a suitable purchaser, and the process for submission of remedies and their subsequent implementation.

In the draft Notice, the Commission indicates that it will continue to favour divestiture commitments over access or similar remedies, and certainly over any behavioural commitments. Despite the European Court's judgment in *Tetra Laval*, the Commission states (at para 17) that "commitments relating to future behaviour of the merged entity may be acceptable only exceptionally in very specific circumstances".

Further, while the Commission accepts that, where the antitrust issue arises from a market position in technology or IP rights, a licence may be the best remedy, it suggests that the granting of IP licences cannot be an effective solution in most other circumstances. The Commission makes its position clear at para 38: "the granting of licences to IP rights instead of a divestiture may be acceptable to the Commission only if a divestiture of a business is not possible and the granting of a licence is as effective as a divestiture".

This inflexibility over behavioural and other structural commitments short of divestiture is disappointing, and is likely to attract widespread criticism from the legal and business community. It remains to be seen whether the Commission will be prepared to adopt a more open approach to behavioural remedies in the final notice.

As regards divestment remedies, as expected, the Commission is imposing more stringent requirements in terms of the scope of divestment packages in an attempt to ensure that they have all the elements needed to put the purchaser in a position to compete effectively with the merging parties. However, in outlining the elements to be included in the divestment package – for example, pointing out that these may need to include activities relating to markets where no antitrust concerns have been identified (see para 23) – there is a risk that the Commission will seek to over-fix the antitrust issue by requiring remedies that go beyond what is needed.

When it comes to suitable purchasers for divested assets, the Commission reveals a certain bias against financial purchasers. It states that where a financial buyer "will not be able or will not have the incentives to develop the business as a viable and competitive force in the market even considering that it could obtain the necessary management expertise (eg by recruiting managers experienced in the sector at stake…", the commitments will need to specify that the purchaser should be an industrial, rather than a financial, purchaser (see para 49). The draft Notice also seeks to provide guidance on when up-front buyers or fix-it-first remedies are needed.

Conclusion

Some of the Commission's policies and practices discussed here have already emerged (or are in the process of emerging) in its more recent merger decisions. However, the publication of a new notice presents the Commission with an opportunity not only to summarise existing practice but also to elaborate on that practice and introduce innovations which will impact on how the EU Merger Regulation applies to transactions in the future. As such, these notices provide valuable tools to the legal and business community involved in the assessment and formal review of transactions under the EU Merger Regulation. The Commission is expected to adopt the new notice on remedies by the end of this year.

References

Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (July, 2007)

Draft Commission Notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004 (2007/)

Council Regulation (EC) No 139/2004

Commission Notice on remedies acceptable under Council Regulation (EEC) No 4064/89 and under Commission Regulation (EC) No 47/98, OJ C 68, 02.03.2001

DG Comp Merger Remedies Study, October 2005

Case C-12/03 *Commission v Tetra Laval*