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E.U. Merger Initiatives

Catriona Hatton and Janet L. McDavid

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The first half of 2007 saw a number of developments in E.U. merger law and policy that will impact the European Commission's assessment of mergers under the E.U. Merger Regulation. Most of the key developments have been initiated by the European Commission in an attempt to clarify existing law and policy in several areas.

The Commission has launched a number of initiatives in the form of notices or guidelines that affect both the scope of its jurisdiction to review mergers under the regulation and the principles to be applied in the assessment of mergers, including the treatment of remedies. These initiatives are not new law. Rather, they are designed to provide guidance based on the Commission's experience in the mergers it has assessed to date and reflect changes brought about by European Court case law and by the new Merger Regulation which entered into force in 2004. While these notices are not legally binding, in a system in which the Commission, rather than the court, has the final say on the vast majority of large mergers, guidelines that reflect the Commission's views are central to E.U. antitrust analysis of mergers.

In July, the Commission adopted a jurisdictional notice on the control of concentrations, and it has published two draft notices for public consultation, one on merger guidelines for companies in a vertical or conglomerate relationship, and another on merger remedies.

Notice focuses on deals that should be deemed mergers

The newly adopted notice consolidates and updates previous notices and deals with the types of transactions that will be considered mergers, including when a joint venture or an outsourcing arrangement will be considered a merger and what revenues need to be taken into account in determining whether E.U. thresholds are met. The latter issue can be complex in cases where acquisitions are made by joint ventures, consortia or investment funds. The following are some of the key points covered in the notice:

• Certain changes in pre-existing joint ventures are notifiable, for example, when parent companies transfer additional assets, such as contracts, know-how or other rights, to the joint venture so as to allow it to extend its activities in the market. Further, a change in the organizational 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 starts dealing with third parties. The notification obligation would arise when the parents decide to change the venture, and approval needs to be obtained before such changes are made.

• The notice also highlights the specific challenges faced by private equity firms and other investors, which may need to monitor investments in companies and joint ventures and identify the point at which a notifiable E.U. merger arises, such as a result of creeping changes in the control of one of their investments or significant changes in its activities or assets. This can be a particular challenge with joint ventures.

• The Commission has in the past identified "antitrust warehousing" as an area of concern, i.e., when the acquisition of a target is made by an intermediary buyer, usually a bank, on behalf of the ultimate buyer. The target is "parked" with the interim buyer pending antitrust approval of the ultimate acquisition and the seller may be paid regardless of whether E.U. 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 favor such structures, as indicated in its review of Vivendi/BMG Publishing in 2006. Under the new notice, the Commission will consider this two-step structure as a single transaction so that the assets cannot be transferred to the bank without the Commission's approval of the acquisition by the ultimate purchaser.

• The notice addresses outsourcing arrangements for the first time. It states that outsourcing deals, such as when a company outsources information technology services, can trigger an E.U. merger filing if 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.

Also, in February, the Commission published for comment a draft notice on the assessment of nonhorizontal mergers. Once adopted, the draft notice will fill an important gap in its guidance on the substantive interpretation of the E.U. Merger Regulation. The Commission rightly notes that vertical and conglomerate mergers are less likely to raise competition concerns than horizontal mergers and, consistent with the approach of other antitrust authorities, that vertical and conglomerate mergers "pose no threat to effective competition unless the merged entity has market power in at least one of the markets concerned." However, the Commission does not provide an indicator of what level of market power could give rise to concern. It identifies a "safe harbour" market share (30% in each affected market) and concentration levels (Herfindahl-Hirschman Index less than 2,000 in each affected market) below which competition concerns are unlikely, but many commentators suggest that the final notice should offer more robust safe harbors and acknowledge that anti-competitive effects are unlikely to arise without significant market power.

The draft notice recognizes that vertical and conglomerate mergers usually achieve efficiencies, which will be taken into consideration in the Commission's assessment. Overall, the draft notice provides a helpful analysis of the factors to be considered in assessing nonhorizontal mergers. The Commission is now reviewing the extensive comments received from the legal and business community on the draft and hopefully will revise the notice to accommodate some comments prior to adoption of the final notice possibly later this year.

In April, the Commission published for comment a draft notice on remedies, which would replace the existing 2001 notice. This initiative was prompted by the results of a study on remedies in 2005 and recent developments in European Court case law. The study assessed the effectiveness of merger remedies in 40 cases between 1996 and 2000. It suggested that the nondivestiture remedies accepted by the Commission were not effective to address the antitrust issues in most cases. For example, in some cases, the Commission accepted remedies such as termination of exclusive rights or granting access to key infrastructure or technology that were not effective. While divestiture to an effective potential competitor is the Commission's preferred remedy, the study also identified a number of problems with the implementation of divestiture remedies. In the meantime, the European Court of Justice in *Commission v. Tetra Laval Sidel*, Case C-12/03, upheld the decision of the Court of First Instance in confirming that "behavioural commitments" in certain instances can be an adequate remedy. The Commission had rejected as insufficient Tetra Laval's commitment not to leverage its strong market position into plastic packaging, but the courts rejected the

Commission's position.

Based on these developments and more recent Commission decisions in which remedies were accepted, it was timely for the Commission to revise its remedies notice. The draft notice provides guidance on many proposed-remedies issues.

Divestiture is still favored over behavioral remedies

The draft notice states that the Commission continues to favor divestiture over behavioral commitments. Notwithstanding the judgment in *Tetra Laval*, the draft notice states that "[c]ommitments relating to future behaviour of the merged entity may be acceptable only…in very specific circumstances." Further, while the Commission accepts that an IP license may be the best remedy when the antitrust issue arises from a market position in technology or IP rights, it rejects the granting of IP licenses as potentially effective remedies in most other circumstances. This lack of flexibility to consider behavioral and other structural commitments short of divestiture is disappointing and is likely to draw widespread criticism from the legal and business community. It remains to be seen whether the Commission will adopt a more open approach to behavioral remedies in the final notice.

The Commission is imposing more stringent requirements on divestitures to ensure that the purchaser can compete effectively with the merging parties. However, in outlining the elements to be included in the divestment package, there is a risk that the Commission will seek to overregulate by requiring remedies that go beyond what is needed.

With regard to identifying suitable purchasers for divested assets, the Commission indicates a bias against financial purchasers when it states that if 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," the purchaser should be an industrial, rather than a financial, purchaser. The notice also seeks to provides guidance on when up-front buyers or fix-it-first remedies are needed.

Some of the Commission's new merger policies and practices have emerged in its more recent merger decisions. However, new notices also present the Commission with an opportunity to introduce innovations in merger review. These notices provide valuable tools to the legal and business communities.

Catriona Hatton *is a partner and co-head of Hogan & Hartson's European competition practice in Brussels, and* ***Janet L. McDavid*** *is a partner in the firm's Washington office.*