

Response dated 5 December 2006 to

Commission of the European Communities

DG Competition

**Consultation on the
Draft Commission Jurisdictional Notice
under Council Regulation (EC) No 139/2004
published on 28 September 2006**



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**FRESHFIELDS BRUCKHAUS DERINGER'S COMMENTS ON THE
EUROPEAN COMMISSION'S DRAFT JURISDICTIONAL NOTICE
UNDER THE EC MERGER REGULATION**

1. INTRODUCTION

1.1 Freshfields Bruckhaus Deringer welcomes the opportunity to comment on the European Commission's Draft Consolidated Jurisdictional Notice (the *Draft Notice*) published on 28 September 2006.

1.2 Our comments are based on our substantial experience of advising parties during European (and national) merger control proceedings. The comments contained in this paper are those of Freshfields Bruckhaus Deringer. They do not necessarily represent the views of any of our clients.

1.3 We strongly welcome the Commission's intention to consolidate its existing jurisdictional guidance within a single notice. This exercise will help to achieve a consistency across the different areas covered by the Draft Notice and will facilitate the analysis of these areas in practice.

1.4 We also welcome the significant areas of new guidance and clarification of the Commission's jurisdictional practice, reflecting both changes introduced by the new EC Merger Regulation¹ (the *ECMR*) and recent European Court case-law and Commission decision-making practice.

1.5 In responding to the Draft Notice, we have recognised the obligation on the Commission to ensure that its guidance reflects the interpretation of the ECMR as stated by the European Courts. Therefore, we have confined our comments to addressing significant areas in the Draft Notice where the Commission's approach is new or materially developed from the existing position. We have focused in particular on issues where there is potentially scope for ambiguity or uncertainty in the current text and where it may be possible for the Commission to clarify further its intended analysis. We have also taken account of discussions at the European Competition Lawyers Forum meeting on 22 November 2006.

1.6 We confirm that none of the information contained in this response is confidential, and that it may be published in full on the Commission's website.

¹ Council Regulation (EC) No 139/2004, OJ 2003 L24/1.

2. MEANS OF CONTROL

Control on a contractual basis

2.1 Paragraph 15 of the Draft Notice states that: “Control can also be acquired on a contractual basis ... such contracts must be characterised by a very long duration Only long-term contracts can result in a structural change in the market.” The accompanying footnote 18 states that “In Case COMP/M.3858 – Lehman Brothers/SCG/Starwood/Le Meridien of 20 July 2005 the management agreements had a duration of 10-15 years; in Case COMP/M.2632 – Deutsche Bahn/ECT International/United Depots/JV of 11 February 2002 the contract had a duration of 8 years.”

2.2 It would be helpful, if possible, to give some further guidance on what time frame the Commission regards as being of “very long duration” or “long-term”. The examples in footnote 18 range from 8 to 15 years. Is it possible for the Commission to indicate that such contracts must generally be over a specific length (for example 5 years) but that, below that time, they would be presumed not to be sufficiently long to pass control?

Acquisitions by investment funds

2.3 Paragraph 19 of the Draft Notice addresses acquisitions of control by investment funds. We welcome guidance from the Commission in this area given the increasing number of private equity transactions that are being caught by the ECMR.

2.4 As an initial comment, we question whether paragraph 19 should be included in the section of the Draft Notice addressing “Means of control”. The guidance provided by paragraph 19 appears to focus on identifying the undertakings concerned (rather than whether there is an acquisition of control) in the specific circumstance of an acquisition by an investment fund. It might therefore be more appropriate to move paragraph 19 to section D of the Draft Notice (“Detailed analysis of different types of concentration”).

2.5 As regards the content of paragraph 19, we have the following comments:

- (a) given the number and nature of the issues covered by the paragraph, we suggest that it could be broken-up to deal with the different points addressed – introduction, control by the investors and the investment company and indications of when control will (and will not) be found in structures involving several investment funds. The Commission might also consider illustrating the principles set out in paragraph 19 in diagrammatic form (as it has done in paragraph 154);
- (b) paragraph 19 refers to the Commission’s “past experience” of acquisitions of control by investment firms, but does not provide any references to published cases. If the Commission is able to point to published decisions by way of illustration of the points that follow (as it has done in other areas), this would prove of practical benefit;

- (c) is it possible for the Commission to provide clarification on what it means by a “*multitude of investors*”? In situations involving investment funds, we presume that the “*multitude of investors*” criterion will normally be satisfied. Would the Commission be able to give an indication of the numerical level at which parties could rule out the possibility of joint control being acquired by individual investors in favour of control being acquired by the fund or the investment company that has set up the fund? For example, would it be possible to state that a “*multitude of investors*” generally means at least four or five shareholders?
- (d) the Commission states that “*the investment company usually exercises control by means of the organisational structure, e.g. by controlling the general partner of funds organised as limited partnerships, or by contractual arrangements*” (emphasis added). We understand that the Commission has examined fund structures where the investment company has been found not to exercise control over the relevant funds, either for the purpose of identifying the group and calculating turnover or for the Commission’s substantive assessment. It would be helpful, if possible, for the Draft Notice to explain what factors might indicate that an investment company did not exercise control in a particular (unusual) case and for any relevant decisions to be cited;
- (e) the Draft Notice is silent on the analysis applicable when an investment company has several investment funds which are *not* linked together under a common brand etc. We suggest it might be useful to explain that – in such a case – the individual funds may acquire control jointly (if this is what is intended);
- (f) the list of indicators of a common control structure exercised by the investment company over different funds begins with the operation of the fund “*under a common brand*”. We question the prominence given to this particular factor as the existence of a common brand – in itself – should not be regarded as evidence of common control;
- (g) in the context of investment companies having control over a number of different funds, the Draft Notice states that “*Further indicators [of this situation] are a general partner without any own resources, only constituting a company structure whose acts are performed by persons linked to the investment company. Via the general partner, the investment company may therefore acquire indirectly the possibility to exercise decisive influence over the portfolio companies held by the funds.*” We suggest that the Commission clarifies further the references to “*general partners*” in this context:
- (i) it is not immediately clear how the existence of the general partner in itself gives the investment company the possibility of exercising decisive influence over the portfolio companies held by the funds. The link between the general partner and the different funds could perhaps be spelt out expressly?
 - (ii) it seems to us that this part of paragraph 19 might, in particular, be worthy of diagrammatic representation to aid clarity.

3. CHANGE OF CONTROL ON A LASTING BASIS

Change of control for a definite period of time

3.1 Paragraph 26 of the Draft Notice clarifies that “A *concentration may arise even in cases in which agreements foresee a definite end-date, if the period envisaged is sufficiently long to lead to a lasting change in the control of the undertakings concerned.*” The accompanying footnote provides illustrations of what time period has been judged too short (3 years) and sufficient (8 years) to constitute “a *lasting change*”. As stated previously (see paragraph 2.2 above), to the extent that the Commission is able to give any more definitive guidance on this issue (potentially by means of the application of presumptive thresholds) this would be welcomed by practitioners and parties alike.

Break-up bids

3.2 Paragraphs 28-31 address when a concentration will occur in a break-up bid situation. This guidance, replacing the previous concept of joint control only for a “*legal instant*”, is welcomed. However, we would query whether it might be possible to clarify the conditions set out in paragraph 29 as to when the Commission will not examine the initial acquisition in a break-up bid situation. In particular:

- (a) the requirement that the subsequent break-up be agreed between the purchasers in a “*legally binding way*” is potentially unclear. It would be helpful for the Commission to clarify whether the requirement is merely for a contractual obligation to break-up the target, or whether that obligation must be wholly unconditional;
- (b) the Draft Notice states that there should be certainty that the subsequent break-up should take place “*within a short time-frame*”. This is intended to be juxtaposed with the reference in paragraph 31 to “*a longer transitory period*”. However, no guidance is given on what the Commission regards as an acceptably “*short time-frame*”. For example:
 - (i) would three years be too long? Based on the logic of footnote 34 (that the break-up bid involves the first acquisition not occurring on a “*lasting basis*”), it could be understood that a period of three years between first acquisition and break-up might constitute a “*short time-frame*” given that it is clear from footnote 33 that such a period would not be sufficient to satisfy the lasting basis criterion;
 - (ii) is one year intended as the acceptable time limit? It might also be possible to conclude that the one year timescale referred to in paragraph 32 (with reference to start-up joint control over a joint venture) might be applicable by analogy.

Some clarification as to which of the above approaches is correct would be useful.

(c) paragraph 29 states that “*the second condition will normally require that the first acquisition can only proceed if merger-control clearance for all concentrations resulting from the split-up of the assets has been obtained.*” This raises a number of questions which could usefully be clarified:

- (i) in what (unusual) circumstances might merger control clearance *not* need to be obtained? Might this be the case where merger control regimes are voluntary (given that footnote 34 refers to “*any obligatory merger-control clearance*” (emphasis added))?
- (ii) are there any other circumstances in which merger control approvals for the break-up may not be required for the first acquisition to proceed?
- (iii) we presume that the reference to “*merger-control clearance*” includes merger control at national level (including controls outside the EU Member States) rather than merely merger control under the ECMR. Is this correct?

3.3 The last sentence in paragraph 30 states that “*In any case, it must be noted that the scope of a clearance decision will only allow for a takeover of the entire target if the break-up can proceed within a short time-frame afterwards and the different parts of the target undertaking are directly sold on to the respective ultimate buyer.*” We believe that the drafting of this sentence is potentially confusing, given its context. The clearance decisions relating to the notification of acquisitions of parts of the target (once broken-up) would clearly not examine the economic effect of the acquisition of the entire target. We suggest that the sentence is clarified to state that any clearance decisions for the parts of the business following break-up allow the initial (entire) acquisition to proceed without notification only if the conditions laid down in paragraph 29 are satisfied.

3.4 We suggest that the Commission confirms that – where the conditions for a break-up bid are satisfied – the undertakings concerned (for the purpose of calculating whether there is a Community Dimension under Article 1 ECMR) are (for each subsequent transaction) the acquirer and the part of the target which they are acquiring, rather than the original purchaser and the entire target before being broken up.

4. INTERRELATED TRANSACTIONS

Transactions linked by conditionality

4.1 Paragraph 38 of the Draft Notice discusses the requirements for conditionality if two or more transactions are to be treated as a single concentration. It is classically stated that conditionality is demonstrated if the transactions are linked *de jure* (i.e. agreements linked by mutual conditionality). However, the Draft Notice also provides for *de facto* inter-conditionality (which is said to be “*economic assessment of the interdependence between the transactions according to the economic aim pursued by the parties.*”) The paragraph goes on to state that “*An indication for interdependence of several transactions may further be the statements of the parties*

themselves or the simultaneous conclusion of the relevant agreements; in any case, a conclusion of de facto interconditionality of several transactions will be difficult to reach in the absence of their simultaneity. A pronounced lack of simultaneity of legally inter-conditional transactions may likewise put into doubt their true interdependence.”

4.2 Whilst recognising the teleological principles underlying the Commission’s identification of *de facto* interconditionality, the drafting of paragraph 38 raises several practical questions which could potentially lead to an undesirable level of uncertainty in seeking to determine jurisdiction:

- (a) the reference to the “*statements of the parties themselves*” is potentially ambiguous. Presumably this refers only to statements made at the time of conclusion of the arrangement? Does it refer to public statements or those made to the Commission itself? Does it require that both parties understand, and have made statements, that the transactions are mutually conditional or is it sufficient that the purchaser alone regards the transactions as inter-conditional and makes statements to this effect?
- (b) it is potentially unclear from the statements quoted above whether it will be possible to find *de facto* inter-conditional where agreements are not concluded simultaneously. Paragraph 38 refers to simultaneity as “*an indication*” but then goes on to state that “*A pronounced lack of simultaneity of legally inter-conditional transactions may likewise put into doubt their true interdependence*”;
- (c) given the practical importance of this point, is the Commission able to point to what other factors it will analyse to determine whether *de facto* inter-conditional is present?

4.3 Paragraphs 39-43 of the Draft Notice distinguish between various scenarios where interrelated transactions would or would not be treated as a single concentration. It would be helpful, if possible, if the Commission were to clarify the following points:

- (a) are parallel acquisitions of control by undertaking A of undertakings B and C from the *same* seller (as well as separate sellers) intended to be covered by paragraph 41, or would such a situation be assumed to be covered by Article 5(2) ECMR (transactions between the same persons within a two-year period) such that inter-conditional is not required in these cases?
- (b) would the same principles also apply to an acquisition of a non-controlling interest where this is inter-conditional with an acquisition by the same purchaser of a controlling interest in another undertaking from the same seller (as is suggested by the Commission’s decision, for example, in Gruner + Jahr/MPS M.3648)? If so, should paragraph 39, which indicates that acquisitions of non-controlling stakes should never be linked with acquisitions of controlling stakes, be modified to take account of this?

- (c) paragraph 43 explains that asset swaps will not be treated as a single concentration. Given the increasing number and complexity of swap transactions (including share swaps), is it possible to expand the explanation of how the Commission reviews different types of swap transaction? For example, we assume that where undertaking A buys undertaking B from undertaking C in exchange for C acquiring undertaking D from A, these would not be treated as a single concentration (even if inter-conditional). However, it is potentially unclear whether the following scenario could be treated as a single concentration: undertaking A buys undertaking B from undertaking C in exchange for C buying a (controlling or non-controlling) stake in A. This could be usefully clarified.

5. CHANGES IN THE QUALITY OF CONTROL

Change from negative control to sole control

5.1 Paragraph 79 of the Draft Notice states that “*a change in the quality of control is the decisive element in assessing whether a change in a given control structure of a company is considered an acquisition of control.*” Paragraph 81 applies that principle to the change from negative to sole control. It states “*similar to a change from joint to sole control, the possibility to determine strategic decisions on its own is of a different quality than the mere possibility to veto strategic decisions.*”

5.2 It is clear from Article 3(1) ECMR that a change in the number of undertakings having control (e.g. going from sole to joint or joint to sole control) will constitute a concentration. However, it is not immediately obvious from Article 3(1) ECMR that a concentration should result from a change from (sole) negative to sole (positive) control. Any clarification of the legal basis for distinguishing between different levels of sole control (and the consequences of moving between different levels of control) would therefore be helpful. Notwithstanding this issue of legal interpretation, we believe that the Commission’s view that such changes will constitute a notifiable concentration will lead to the following practical difficulties:

- (a) the Commission is likely to see an increase in the number of “technical” or “procedural” repeat notifications being made (most likely under the simplified procedure), as was the case in *BBVA/BNL*². Following a clearance of the acquisition of negative control, we query how many cases will result in an adverse finding brought about by the change to (positive) sole control. We suggest that this may lead to an undesirable increase in the use of Commission (and parties’) resources, in particular given the need for the Commission to devote time to the analysis of more substantive concerns; and
- (b) classifying the change from negative to sole control as a further concentration will presumably require the Commission to identify in a decision when sole control is being acquired on a negative basis (such that the notifying party is alive to the possibility of a further notification being required if it were to

² Originally Case No COMP/M.3537; subsequently Case No COMP/M.3768 when BBVA subsequently acquired full sole control over BNL.

acquire (positive) sole control). Otherwise, parties will be exposed to an increased level of risk of failing to notify and breaching the suspensory obligation following, for example, an involuntary acquisition of *de facto* (positive) sole control resulting from a falling presence of other shareholders at a shareholders' meeting.

Reduction in the number of shareholders

5.3 Paragraphs 86 and 87 address the situation where there is a reduction in the number of shareholders having control over a joint venture. Paragraph 87 states that, although a reduction in the number of undertakings holding joint control will not normally constitute a concentration, *“the situation may be different if the number of jointly controlling shareholders is reduced to two and if the operation gives the remaining controlling shareholders additional veto rights or considerable more weight in the decision-making process (apart from a numerical increase of their voting rights). ... If more than two controlling shareholders remain, however, the shareholders will normally not gain sufficiently more weight in the decision-making process to change the quality of control.”*

5.4 The emphasis in the reduction in the number of shareholders to two contrasts with the reference in paragraph 39 of the Commission's previous Notice on the Concept of Undertakings Concerned³ to the *Avesta II* decision⁴. There, a concentration was found when the number of shareholders decreased from four to three. Given the fact that this case was specifically identified in the earlier Notice, we would suggest – to avoid confusion – that the Commission clarifies whether the *Avesta II* case is an unusual one (and, if so, why), or whether the Commission's practice in this area has changed since the publication of the earlier Notice. (We note that the Commission has clarified in the context of joint control for a start-up period that the Draft Notice marks a departure from previous guidance – see paragraph 32.)

6. FULL-FUNCTIONALITY

Concept of full-functionality

6.1 Paragraph 88 of the Draft Notice states that *“the acquisition of joint control of another undertaking, which has a market presence, constitutes a concentration The full-functionality criterion is therefore not required for the acquisition of joint control of an undertaking (with a market presence) from third parties. As in the case of the acquisition of sole control of an undertaking, such an acquisition of joint control will fall already under Article 3(1) as it will in any case lead to a structural change in the market, as set out in recital 20, even if it should be envisaged that the acquired undertaking will no longer be full-function after the transaction”*

6.2 The paragraph is clear that, for such a transaction to qualify as a concentration, full-functionality is not required *after* the transaction. However, paragraph 88 is potentially ambiguous as to whether full-functionality is required *before* the

³ OJ 1998 C66/14.

⁴ Case IV/M.452, 9 June 1994.

transaction. We understand that the Commission intends paragraph 88 to clarify that, for an acquisition (or change) in joint control of a pre-existing “undertaking” (within the meaning of Article 3 ECMR), full-functionality is not required either before or after the acquisition. If this is correct, it could be usefully clarified with an appropriate cross-reference to paragraph 22 to explain the relevance of the term “*market presence*” in defining the object of control. It would also be helpful, if possible, to provide examples of the types of situation that would qualify as a concentration where the target undertaking had a “*market presence*” before the transaction but was not full-function either before or after the transaction and why these types of transactions may give rise to competition concerns.

Changes in the activities of the joint venture

6.3 Paragraph 103 states that a concentration may arise (even without the transfer of assets from the parents) if a number of criteria are satisfied, namely that:

- (a) the enlargement would qualify as the creation of a full-function joint venture when considered in isolation;
- (b) there are elements that demonstrate that the parent companies are in fact the real players behind this operation; and
- (c) the enlargement of the joint venture’s activities is not to be considered as “*organic growth*” of the joint venture.

6.4 These criteria raise a number of questions that could usefully be clarified:

- (a) is paragraph 103 only intended to capture situations in which the joint venture makes acquisitions of the whole or part of another undertaking?
- (b) if the answer to sub-paragraph (a) above is no (and paragraph 103 includes, or is limited to, enlargements achieved other than by acquisition), it would be helpful if the Draft Notice could provide examples of the types of operation that could take place (clearly excluding acquisitions and transfers of assets from the parents) that would lead to a change in the structure of the market (as required by Recital 20 to the ECMR);
- (c) is the Commission able to clarify when parents would and would not be considered to be the “*real players*” behind the operation (particularly as the Draft Notice recognises that the joint venture does not need to enjoy “*autonomy as regards the adoption of its strategic decisions*” (paragraph 89))?
- (d) paragraph 103 states that a concentration will not arise where the enlargement is to be considered to be “*organic growth*” of the joint venture. It would be helpful if the Commission clarified what is meant by this term. For example:
 - (i) must the enlargement be qualitatively confined to the same or neighbouring economic markets to those in which the joint venture was active at the time of its original clearance?

- (ii) is “*organic growth*” limited to small quantitative increases in the size of the joint venture’s activities (and if so, is it possible to provide any illustration of the magnitude of an enlargement that would be presumed to exceed “*organic growth*”)?
- (iii) is the wording of the joint venture’s original business plan or of the Commission’s clearance decision of evidential relevance here?
- (iv) is the Commission aiming to capture situations in which the joint venture’s board could reasonably have come to the decision to expand without intervention from its parent companies?

To the extent that the Commission is seeking to capture situations falling under any of the above tests, we suggest it might be preferable to refer to them directly, rather than simply by reference to the concept of “*organic growth*”.

7. CONCLUSION

7.1 We would like to emphasise again that we strongly welcome the Commission’s intention to consolidate its existing jurisdictional guidance within a single notice and to provide the new and updated areas of guidance. In providing comments in this response, we are endeavouring to suggest ways in which the Commission could further clarify certain specific issues.

7.2 We would be happy to provide any further explanation of the points raised in this response, either in a meeting or otherwise. Please contact Thomas Wessely (+32 (0)2 504 7027) or Sarah Jensen (+44 (0)20 7832 7092) if such further discussion would be helpful.

**Freshfields Bruckhaus Deringer
5 December 2006**