

COMMENTS ON THE EUROPEAN COMMISSION'S DRAFT CONSOLIDATED JURISDICTIONAL NOTICE

Lovells

1. SUMMARY OF PRINCIPAL COMMENTS

Lovells welcomes the Commission's issue of a consolidated jurisdictional Notice. As legal advisors we are particularly concerned with the clarity and certainty of legal tests and the avoidance of unnecessary administrative burden. By consolidating the four old Notices into one new Notice, by taking into account the legislative changes introduced in 2004 by the new Merger Regulation, and by setting out recent case law and current Commission practice, the Commission has produced guidance which provides significant assistance to the business and legal community.

In general, we support the content of the draft, and would urge the Commission to adopt formally the draft substantially in its current form as soon as possible. We hope that swift adoption will be possible, especially in view of the fact that the Notice is not introducing substantive change, but rather setting out current law and practice. The adoption of a Notice which incorporates the changes introduced by the new Merger Regulation is timely considering that it is now nearly three years since the new Merger Regulation was adopted.

As set out in detail below, we believe that there are some parts of the draft Notice which could benefit from clearer drafting, and where further examples of the Commission's current practice could be added. In addition, more extensive cross-referencing between the various parts of the draft would be helpful.

We have three main comments.

- 1.1 The draft Notice does not provide sufficient clarity on the circumstances when an undertaking needs to notify as a concentration a change in the nature of sole control. We have particular concerns regarding Paragraph 81 which suggests that a change from negative to sole control automatically constitutes a notifiable concentration. We suggest that this test is redrafted to make clear that where an undertaking changes its level of interest or influence in another undertaking, this is only notifiable in exceptional circumstances when there is a significant change in the nature of control. There is otherwise a serious risk of unnecessary administrative burden on business, especially in view of the fact that changes in the nature of sole control are very rarely going to raise material competition concerns. We believe that in the exceptional circumstances where a change in the nature of sole control requires notification, the simplified procedure should be adopted. For more detail, see our comments on Paragraph 81 below.
- 1.2 We consider that the draft Notice introduces an overly-complicated and burdensome method for calculating turnover for credit and financial institutions (other than financial holding companies). We believe that the Notice should not differentiate between turnover which is "customer-related" and other turnover, but apply one single method which is to allocate turnover to the branch or division of the financial institution which receives the income. This conforms with what is prescribed in Article 5.3 (a) of the EC Merger Regulation, and in paragraph 54 of the Turnover Notice. Furthermore, it is a simpler method for the business and legal community to apply. For more detail, see our comments on Paragraphs 178-179.
- 1.3 We have concerns with the guidance provided in Paragraph 88 regarding the acquisition of joint control of another undertaking. The Notice does not clearly explain the circumstances when the full-function test need not be applied. It introduces a "market

presence" test, and does not explain how this is different from the full function test. In general, we would urge the Commission to accept that a transaction resulting in a jointly controlled undertaking is notifiable as a concentration only if it is full function. For more detail, see our comments on Paragraph 88.

2. DETAILED COMMENTS

2.1 Part A - Introduction

Paragraph 1, second sentence - We believe that the Commission should state that the aim of the consolidated Notice is not just to "enable firms to establish more quickly" jurisdiction, but to provide "additional clarity and certainty" to "business and its advisors", not just "firms".

2.2 Part B - The concept of "concentration"

Paragraph 15 - We believe that the Commission should emphasise that control being acquired purely on a contractual basis is an exceptional circumstance.

Footnote 19 - It would be clearer to state that contracts equivalent to the "Beherrschungsvertrag" and "Contrato de subordinação" "do not exist in all Member States", rather than "may not be admissible in all Member States".

Paragraph 19 - It would be helpful to explain that limited partners usually do not exercise control. Under English law a limited partner by definition must not be able to exercise control.

Paragraph 22, final sentence - We suggest that an additional sentence is added which makes it explicitly clear that the grant of an exclusive licence without additional assets does not constitute a concentration unless this grant leads immediately to the licensee acquiring turnover-generating activity with third parties.

Paragraph 24 - It would be helpful if the Commission could specifically refer to a time period, rather than time frames which are "similar" to those referred to under points 93 and 96. We believe that normally a one year time period for third party market access should be necessary, and that certainly it should not exceed three years.

Paragraph 34 - There is a reference in paragraph 34 suddenly to Article 5(2)(2), yet there is more detailed discussion of Article 5(2)(2) in paragraphs 45 and 46. We believe that paragraphs 34, 45, and 46 could be better linked together.

Paragraph 46 - penultimate sentence. It would be helpful to have specific examples given for situations "where it does not appear appropriate to apply Article 5(2) subparagraph 2 to different transactions in cases involving an undertaking concerned which is distinct from the identical seller(s) and buyer(s)."

Paragraph 54 - It would be helpful if the Commission could set out in more detail when an option can be regarded as "easily and quickly exercisable".

Paragraph 73, final sentence - The Commission states that, even in the absence of explicit agreements, there may be "decision making procedures which are tailored in such a way as to allow the parent companies to exercise joint control". It would be helpful if the Notice could provide examples of the types of "decision making procedures" it is referring to.

Paragraph 81 - We believe that the Commission should provide further clarification of when a change in the nature of sole control requires notification. Such clarification is essential to avoid undue administrative burden for business. Changes in the nature of

sole control are very rarely going to raise material competition concerns, and so notification should only be necessary in certain very limited circumstances.

The draft Notice introduces the concept of a new level of control, called "negative control", and a rule that a change from this level to sole control automatically gives rise to a concentration (see last sentence of Paragraph 81). We find this rule as expressed to be confusing and potentially too far-reaching.

It would be clearer if the Commission avoided the creation of a new category of control called "negative control". The Notice should distinguish two categories within sole control. The first would be "positive sole control" where an undertaking has a positive level of control, ie an ability to determine strategic decisions on its own by, for example, having preferential shares that enable it to determine the strategic commercial behaviour of another company, or by being likely to be or forming part of a majority at annual shareholders' meetings. The second would be "negative sole control" where the undertaking has the mere possibility to veto strategic decisions.

We believe that the Commission should make clear that a change in the nature of sole control should only be notifiable in exceptional circumstances. This should only be where the nature of sole control is materially different. A change from *de facto* to *de iure* sole control, or where a 51% shareholder (with no other shareholder having joint control) acquires a larger shareholding should not be notifiable.

We believe that in the exceptional circumstances where a change in the nature of sole control requires notification, the simplified procedure should be adopted. The Notice on simplified procedure currently only provides for the use of the simplified procedure in the case of a move from joint to sole control (Paragraph 5 (d) of the Notice on simplified procedure).

Paragraph 88 - We find this paragraph confusing, in particular the following sentence: "The full functionality criterion is therefore not required for the acquisition of joint control of an undertaking (with a market presence) from third parties".

The sentence appears to indicate that for the creation of certain joint ventures full-functionality is not required. It is not clear whether the Notice is suggesting that the full-functionality test only not be applied for the specific circumstance outlined in the last sentence of the paragraph (where two or more undertakings acquire joint control of a pre-existing undertaking in circumstances where it will subsequently cease to be full-function because the parents will cause the joint venture to sell its output exclusively to its parents), or more generally.

The test of "market presence" is not explained in the paragraph. It would have been helpful if the draft Notice could have explained how this is different from the concept of "full function".

The test as set out in this paragraph could lead to the different treatment of two scenarios.

Scenario 1 - If company A decides to acquire a 50% share in company B's 100% subsidiary, S, which has none of its own resources, but acted at some point as B's sales agency, full-functionality is still a required condition (since S is not acquired from a "third party").

Scenario 2 - If company A and company B decide to acquire a 50% share each in company C's 100% subsidiary, S, which has none of its own resources, but acted at some point as C's sales agency, full-functionality would apparently not be a condition - but market presence would be a condition.

It is not clear to us why the above scenarios should merit the application of different tests. In general, we would urge the Commission only to accept that a transaction resulting in a jointly controlled undertaking is notifiable as a concentration if it is full function.

Paragraph 101 - We would encourage the Commission to take a flexible and commercial approach to the issue of whether the award of a licence is sufficiently uncertain that a joint venture cannot be regarded as having "sufficient operations on a lasting basis", and therefore does not give rise to a concentration. The application of this rule should not lead to a joint venture being disadvantaged in a bidding process since it is not able to obtain clearance from the Commission prior to contract award.

Paragraph 103 - It would be helpful if the Notice could provide further guidance of when the enlargement of a joint venture's activities might constitute a new concentration. In particular, clarification is required of when the enlargement of activities might be regarded as more than "organic growth". We believe that the enlargement of a joint venture's activities should only constitute a new concentration in exceptional circumstances for reasons of legal certainty and to avoid undue administrative burden.

2.3 **Part C - Community Dimension**

Paragraphs 123-129 - It would be more logical if the full analysis of the notion of undertaking concerned was set out before the section on turnover. For this reason, we suggest that Section D is incorporated within this section and before the section on turnover.

Paragraph 155 - It would be helpful to expand within this paragraph the points made in paragraph 160, namely that the test under Article 5 (4) is different from Article 3 (2) by not including situations of economic dependence, and that the "right to manage" does not cover negative control issues. The distinction made in paragraph 160 is a helpful clarification of the rules, and assists in creating a bright line test for calculating turnover.

Paragraph 157 - Line 6 of this paragraph should be clearly cross-referenced with paragraph 163 to clarify that only half of the turnover of b3 is taken into account.

Paragraph 176 - It would be helpful if the Commission could list all, not just a selection, of the relevant activities of credit institutions, as is done in paragraph 52 of the Turnover Notice.

Paragraphs 178 - 179 - The draft Notice introduces two different methods for the calculation of turnover of credit and financial institutions (other than financial holding companies). Where turnover is "customer-related (such as income generated by lending to customers, by trading in securities for account of customers or by money transmission)", turnover is to be attributed to the place where the customer is located. Where "the banking business is not carried out for a direct customer (eg in case of trading for own account or income from shares and other variable yield securities)", turnover is to be allocated to the branch or division of the financial institution which receives this income.

We believe that the introduction of two different methods for the calculation of turnover depending on whether turnover is "customer-related" introduces significant complexity to the calculation of turnover. As currently drafted, it will be difficult for credit and financial institutions to distinguish what is "customer-related". We consider that the Commission should apply a single method for the geographic allocation of turnover for credit and financial institutions, which is to allocate turnover to the branch or division of the financial institution which receives the income. This approach is in conformity with Article 5.3 (a) of the EC Merger Regulation which states: "The turnover of a credit or financial institution in the Community or in a Member State shall comprise the income items, as defined above,

which are received by the branch or division of the institution established in the Community or in the Member State in question, as the case may be", and with paragraph 54 of the Turnover Notice. This approach would also be in the spirit of the 1997 amendments to the rules on calculating turnover for credit and financial institutions which changed the method based on the value of an institution's assets in the spirit of simplification.

Paragraphs 185 and 186 - We consider that these paragraphs are unclear. Paragraph 185 indicates that all the income from investments held by insurance undertakings (used to constitute appropriate reserves allowing for the payment of claims) should be taken into account and calculated according to the general rules (as opposed to the specific rules for insurance undertakings). This is contrary to the rule in paragraph 57 of the Turnover Notice which states that this turnover is not to be considered as turnover. Paragraph 186 appears to qualify the rule established in paragraph 185, by stating that "pure financial investments" should not be added to turnover. This appears to bring the rules back in line with paragraph 57 of the Turnover Notice. We encourage the Commission to clarify that the rules set out in paragraphs 57 and 58 still apply, and therefore suggest that the draft Notice follows more closely the wording of the Turnover Notice.

Paragraphs 199 and 200 - We suggest that these paragraphs deal more clearly with the situation where a pre-existing company was under the sole control of one company and a new shareholder takes joint control. It is stated expressly in paragraph 23 of the Notice on concept of undertakings concerned that where a pre-existing company was under the sole control of one company and a new shareholder takes joint control of that company, the undertakings concerned are each of the jointly controlling companies, and not the target company. It is not entirely clear whether this scenario would fall within paragraph 199 of the draft Notice (which refers to the situation in which one undertaking contributes a pre-existing subsidiary or a business to a newly created joint venture, in which case it states that each of the jointly controlling undertakings is considered to an undertaking concerned), or whether it would fall within paragraph 200 (which refers to the acquisition of control of a pre-existing undertaking or business, in which case it states that the undertakings concerned are each of the joint controllers and the pre-existing acquired undertaking). We assume that the scenario set out in paragraph 23 of the existing Notice is intended to fall within paragraph 199 of the draft Notice (since this would be consistent with the current approach), but this could be made clearer in the wording. The rule as set out in paragraph 200 should only apply where two new shareholders take control of a pre-existing business.

2.4 **Part D - Detailed analysis of different types of concentration**

Paragraph 203 - It would be helpful to indicate here that the reduction in the number of controlling shareholders in a joint control situation leading to a change in the quality of control and therefore a concentration is an exceptional circumstance, and to cross-refer to the specific paragraphs earlier in the Notice which deal with this point.

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