

## Comments on the Draft Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings

### 1. Introduction

Mayer, Brown, Rowe & Maw LLP welcomes the opportunity to comment on the Draft Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings ("**Draft Notice**").

This document reflects the views of Mayer, Brown, Rowe & Maw LLP, and it does not represent the views of any of our individual clients. Our comments refer in particular to the section of the Draft Notice dealing with the acquisition of control by investment funds (para. 19 Draft Notice ).

An ever increasing number of M&A transactions involve the acquisition of control by investment funds, which often have complex organizational structures. Therefore, the initiative of the Commission to provide specific guidance on the question of how control is exercised, and who exercises control over investment funds, addresses actual issues faced by competition law practitioners.

However, we believe that this guidance could be more instructive if certain elements of the Commission's draft were clarified and further developed. The specific elements considered are explained in greater detail below.

### 2. Control over Investment Funds

As the Draft Notice points out, individual investors do not normally exercise control over investment funds, either solely or jointly. Usually, in the absence of special facts, investment funds are independent entities and therefore the fund itself constitutes the ultimate entity for control purposes.

The Draft Notice adds, however, that a fund "typically" may be controlled (a) by the investment company which has set up the fund on the basis of contractual arrangements, or (b) by a company which "operates" multiple funds under a common brand, combined with a common organizational structure.

We do not agree that control over investment funds is typically exercised by another party through contractual agreements, and we suggest that further clarification of the concept of control deriving from a common organizational structure is necessary.

#### a) Contractual Arrangements

Where a fund concludes a management agreement (or an investment advisory agreement) with another party (such party usually being called the Manager), the principles for the assessment of control should be those that are developed in general for the issue of acquisition of control through contractual arrangements.

Paragraph 15 of the Draft Notice explains the criteria for the acquisition of control on a contractual basis. According to the Draft Notice, control on the basis of contractual arrangements will be acquired if the arrangements cause a structural change; to that extent,

the agreements must be of a "very long" duration, and without a possibility of early termination for the party granting the contractual rights. The Draft Notice provides examples of certain possible types of "controlling" contracts to be entered into under national laws, such as the "Domination Agreement" (*Beherrschungsvertrag*) under Section 291 German Stock Corporation Act or the Portuguese "Subordination Contract" (*Contrato de Subordinação*).

In our experience, investment management agreements do not typically confer on the Manager control over investment funds, either in terms of substance or in terms of duration.

In substance, management agreements do not confer the degree of control that, for instance, Domination Agreements do. Domination Agreements confer on the "dominating" (*i.e.*, controlling) entity unrestricted power to issue instructions to the Board of the company under control in relation to all the strategic and commercial behavior. This is not generally true for investment companies managing or advising funds. The management power is usually restricted by certain rights retained by investors in order to oversee the Manager's activities. It may also be restricted by further rights such as those which can be conferred on limited partners by partnership agreements, including, *inter alia*, the right to approve investments above a certain monetary threshold (usually indicated as a percentage of the total commitment), transactions between funds commonly managed by the same Manager and other matters.

These rights or powers customarily retained by limited partners (*i.e.*, the investors) serve to align the incentives of investors and Managers. Further, those powers are used by the individual investors, who bear the investment risks, to restrict the freedom of the Managers. Domination Agreements may serve again to illustrate the differences. While in a Domination Agreement, the controlling entity bears the entire financial and economic risk of the controlled companies, Managers of investment funds do not share such a burden to the same extent as the fund's investors (see also Case COMP/M.3136 – *GE/Agfa NDT* of 5 December 2003 concerning a specific contract to confer control over entrepreneurial resources, management and risks). Therefore, unlike in the case of Domination Agreements, the economic interest remains with the fund's investors.

Regarding duration, in general management agreements extend only for the lifetime of a fund, which is often less than the period which the Commission in the past has considered long enough to constitute long-term contracts (see for instance Case COMP/M.3858 – *Lehman Brothers/SCG/Starwood/Le Meridien* of 20 July 2005 – the management contracts had a duration of 10 to 15 years; Case COMP/M.2632 – *Deutsche Bahn/ECT International/United Depots/JV* of 11 February 2002 – the contract had a duration of 8 years). In our experience, a fund's life time is – on average – only five to seven years. If the Commission believes that management contracts may confer control irrespective of the duration of the management agreement or the lifetime of the fund, it would be helpful if this was clarified, given that available precedents suggest that management contracts may not be long enough to confer control.

Furthermore, control, *i.e.*, lasting and stable control, may always be at risk in investment funds. It is customary that investors have the right to dismiss the Manager by exercising any of the provisions included in the early termination clause of the management agreement. It is indeed our experience that management contracts are terminated by investors. Among other reasons, early termination provisions usually allow dismissal of the Manager if, for instance, the Manager fails to achieve a targeted rate of return on the investments made.

The Draft Notice should explain in greater detail the scope of the powers conferred on Managers needed to bestow control. Such explanation is all the more important as it would also clarify the Draft Notice's initial statement that investment funds are independent entities. Where Managers are not able to exercise control on the basis of contractual agreements, and where investors do not exercise joint control over investments funds – as for legal reasons they are barred to do so – each individual fund would normally constitute a separate legal entity for merger control purposes. In this respect, it would also helpful if the Commission would clarify the extent to which the criteria developed for the assessment of joint control would be applicable to investment funds.

#### **b) Organizational Structure**

Our other comment concerns the following statements regarding the case of an investment company setting up different funds: (i) different funds are normally linked together by their relationship with the investment company, and (ii) the operation of the different funds under a common brand, combined with a common organizational structure for the control of those funds or with contractual arrangements, are indicators of a common control structure over all the different funds.

In this sense, it would be helpful if the Commission clarified the meaning of the term "linked by their relationship". The mere fact that one investment company has entered into management agreements with different funds, and may use an "umbrella" brand, should not, in general, serve as an indicator of common control. There are a variety of scenarios that may make it necessary to come to varying conclusions. Considering that it is questionable that Managers typically exercise control over an investment fund, and that investors do not have joint control over the funds in which they invest, it follows that the notion of "linkage" between funds should be afforded greater clarity. Often, different funds of a single management company have entirely different investors, and these funds pursue different investment objectives in terms of capital commitments, industry, territory and duration. Moreover, investors normally approve in advance the combination of portfolio companies owned by different funds commonly managed by the same Manager.

If "linked by their relationship" refers to economic relationship or economic dependence, comparable to the concept of *de facto* control (paragraph 17 Draft Notice), the Draft Notice may usefully clarify what other links – as they are required for the conclusion of *de facto* control (usually structural) – are needed in order to establish control. As such, greater guidance would be helpful as to when different funds, and their controlled portfolio companies, should be taken into account for merger control purposes.

### **3. Final Remarks**

Given the burden which may be imposed on private equity funds in relation to transactions incapable of creating substantive competition concerns, any further clarification on how control is exercised, and who exercises control, over investment funds in the terms reflected above will certainly be welcomed.

For any questions, please contact Kiran Desai (kdesai@mayerbrownrowe.com) and Jens Peter Schmidt (jpschmidt@mayerbrownrowe.com), both Brussels; Gillian Sproul (gsproul@mayerbrownrowe.com), London; Hans-Georg Kamann (hgkamann@mayerbrownrowe.com), Frankfurt; or Richard Steuer (rsteuer@mayerbrownrowe.com), New York.

**Mayer, Brown, Rowe & Maw LLP**  
**Brussels/Frankfurt/London/New York**  
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