

## Draft Consolidated Jurisdictional Notice under the ECMR - Response to the Commission's Public Consultation -

December 2006

- [1] WilmerHale welcomes the opportunity to comment on the Commission's Draft Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings ("the Draft Notice"). The comments are based on WilmerHale's extensive experience in assessing and notifying transactions to the Commission and to other competition authorities.
- [2] Overall, the Draft Notice constitutes a significant improvement. The consolidation of the four existing notices on jurisdiction (plus the integration of the additional publication on abandonment of concentrations) in one single document as well as the more detailed treatment of a number of specific situations that previously had been dealt with only in the Commission's decisional practice<sup>1</sup> creates a very useful package that covers most questions relevant for determining jurisdictional questions in EC merger control. In substance, the explanations largely reflect current Commission practice and provide sound and workable standards.
- [3] We have three principal suggestions for further improvement.
- We would invite the Commission to reconsider its proposal to treat changes from negative to (positive) sole control as concentrations (paragraph 81).<sup>2</sup>
  - It would be helpful if the Notice could clarify that parties can notify a joint venture even if the start of operations depends on an uncertain decision of a third party, for example the award of a contract (paragraph 101).
  - We would invite the Commission to reconsider the conditions under which the enlargement or change of a joint venture's activities leads to a new concentration (paragraph 103 and 104).
- [4] In these three areas, the Draft Notice appears to expand or reduce the concept of a notifiable transaction beyond current Commission practice in a way that risks leading to practical and legal difficulties. We discuss this further below, together with some other points that mainly call for additional clarification. The issues are addressed in the same order as in the Draft Notice.

### Object of Control – Transfer of Assets as Concentration

- [5] We have three concerns with paragraph 22, describing when asset transfers can constitute a concentration.

---

<sup>1</sup> Notably, we welcome the clarifications on franchising agreements (paragraph 16), investment funds (paragraph 19) and out-sourcing agreements (paragraph 23 et seq).

<sup>2</sup> All references to paragraph numbers are to the Draft Notice, unless stated otherwise.

- **Transfer of client base.** The statement that “[t]he transfer of a client base of a business can be deemed a concentration” in our view does not provide sufficient guidance and should be complemented by further explanation or examples, if possible. Notably, it is not clear whether the Commission will systematically or only under exceptional circumstances qualify the transfer of a client base as a concentration. The circumstances in COMP/M.2857 (ECS/IEH) appear to be peculiar to the power industry and do not easily lend themselves to generalisation. In many industries, a client base is not stable and therefore is not comparable to “long-term” assets. This militates against treating all transfers of client bases as concentrations.
- **Transfer of intangible assets.** It would be helpful for businesses and their advisors if the Notice provided additional guidance on the transfer of intangible assets. Paragraph 22 states that such transfer “*may also be considered to be a concentration if [the intangible assets] are the basis for an existing economic activity and the assignment of these intellectual property rights seems sufficient for also transferring the turnover-generating activity*”. Many forms of economic activity require both intangible and tangible assets. For example, many pharmaceutical products are “based” on patents in the ordinary sense of the word, but the economic activity (producing and selling pharmaceutical products) also requires significant tangible assets as well. In such cases, the proposed standard that the patents must be the “basis” for the economic activity appears difficult to apply without additional guidance in the Notice.

We would also suggest that the final Notice take a position on the relevance of the remaining period of validity of the transferred intellectual property rights, given that a concentration only arises if there is a lasting change of control.

It would also be useful to clarify whether the transfer of intangible assets must be such that any purchaser could take over the turnover-generating activities (thus, essentially requiring a stand-alone business), or whether it is sufficient that the particular acquirer will be able to do so, for example because he already owns all tangible assets necessary to exploit the transferred intangible assets.

- **Exclusive licenses.** While the last sentence of paragraph 22 makes clear that the grant or transfer of a non-exclusive licence will never constitute a concentration, the Notice should clarify whether and under what circumstances the grant of an exclusive licence can amount to a concentration. It would seem overly broad to qualify every exclusive license as a concentration, but the current wording of the Draft Notice could be understood that way (because of the wording “*will normally*”). We submit that, to constitute a suitable object of control, exclusive licenses must at least fulfil the requirements applicable to the transfer of intangible assets (see above).

### **Change of Control on a Lasting Basis – Length of Transitory Period for Split of Assets and of Start-up Period with Joint Control**

- [6] More specific guidance would be helpful on the permissible length of the transitory period between an initial acquisition and subsequent split of the target’s assets without turning the initial transaction into a concentration. The Draft Notice uses the terms “*short time-frame*” ([paragraph 29](#)) and “*immediate split-up*” ([paragraph 30](#)) and states that a “*longer transitory period*” could not be accepted ([paragraph 31](#)). It would be useful if the Notice could indicate at least the allowed minimum length of any transitory period. For example, in parallel to [paragraph 32](#), it may be sound policy to allow one year for the break-up in all cases and longer periods upon examination of the specific circumstances.<sup>3</sup>
- [7] On the policy change proposed in [paragraph 32](#), i.e. the move to a one-year start-up period of joint control before conversion to sole control, we agree that a three-year period may be too long in some cases to exclude the joint control having an impact on the market. However, one year should not be an absolute figure and the Commission should take account of all relevant circumstances, in particular as Article 5(2)(2) ECMR provides for a two-year period in case of staggered transactions.

### **Categorization into Sole, Negative and Joint Control**

- [8] We welcome that the Draft Notice fully recognizes and explains the situations it refers to as negative control, which were insufficiently addressed in the previous notices.
- [9] However, we submit that it would be more logical and user friendly to treat negative control as a variant of sole control rather than as a third category in addition to (positive) sole control and joint control. Both negative and positive sole control are distinguished from joint control by the fact that only one person or undertaking has the possibility of exercising decisive influence on the object of control, the difference only being that, in the case of (positive) sole control, the controlling person or undertaking has the “*power to impose strategic decisions*” ([paragraphs 56 and 57](#)), while in case of negative control the person or undertaking only “*is able to veto strategic decisions*” ([paragraph 56](#)). [Paragraph 160](#) uses the term “*negative sole control*”, and this appears to be a better way of referring to these situations.
- [10] As a matter of organization of the sections on the different forms of control, we think it is useful that the Draft Notice starts the sections on negative (sole) control and joint

---

<sup>3</sup> As a minor point, reference to Case COMP/M.3372 – *Carlsberg/Holsten* in [footnote 38](#) provides no meaningful guidance on the permitted duration of the transitory period, given that paragraph 5 of the published decision does not indicate how long the duration was in that case. The decision also left open the question whether Carlsberg acquired control of the assets that would be spun off from Holsten (the König and Licher breweries) and sold to another purchaser (the Bitburger brewery).

control with a definition of the essence of the concept in question.<sup>4</sup> We would welcome if the section on (positive) sole control did so as well.<sup>5</sup>

### **Sole Control on a *de facto* Basis**

- [11] The last sentence of paragraph 53 would benefit from clarifying the relationship between *de facto* (positive) sole control and joint control. The Draft Notice qualifies as sole control a situation in which the large minority shareholder “*can count on the shares of other shareholders to achieve such a [stable shareholder’s meeting] majority*”. However, situations in which the joint votes of two or more minority shareholders are required for a majority will more often constitute joint control, which arises under paragraph 70 if “*...the minority shareholders, together, will have a majority of the voting rights; and they will act together in exercising these voting rights.*” We would invite the Commission to clarify in paragraph 53 under what circumstances sole control will exist in such situations. A possible approach could be that sole control will exist if it is likely that the minority shareholder’s vote will be followed automatically by another shareholder and there is no need for the first shareholder to coordinate with the other shareholder or take the latter’s interests into account.

### **Joint Control and Veto Rights**

- [12] Paragraph 61 states that a parent company may have joint control of a joint venture if veto rights exist for votes at the board of directors of the joint venture, but only “*to the extent that the parent companies are represented on this board*”. In other words, the veto rights held by a board member are attributed to the parent company that the board member represents. We would welcome a clarification of the concept of representation in this context. Notably, it would be useful to specify whether a representative must be an employee or director of the parent entity (or one of its group companies) or whether it is sufficient that the person has been appointed or proposed for appointment by the parent entity in question. The same issue of representation arises in paragraph 61 regarding voting requirements in special approval bodies, such as supervisory boards.
- [13] Paragraph 65 suggests that veto rights over either appointment and dismissal of senior management or the budget lead to joint control. Apparently, a shareholder with one of these two veto rights automatically will have joint control and it is neither

---

<sup>4</sup> Negative control “*exists where only one shareholder is able to veto strategic decisions in an undertaking, but this shareholder does not have the power, on his own, to impose such decisions ...*” (paragraph 56, first sentence). “*Joint control exists where two or more undertakings or persons have the possibility of exercising decisive influence over another undertaking ...*” (Paragraph 58, first sentence).

<sup>5</sup> The essence of sole control being that one person or undertaking has the possibility of exercising decisive influence on another undertaking (Article 3(2) ECMR), positive sole control would exist if the person or undertaking has the power to impose strategic decisions, while negative sole control would be characterized by the ability of a person or undertaking to produce a deadlock situation on questions of strategic commercial behaviour without, however, being able to impose such decisions by itself.

necessary nor possible to look at other indicators of control or specific circumstances of the case. If this is what the Draft Notice has in mind, it may be useful explicitly to state this, especially as paragraphs 64 and 69 suggest that there are no automatic rules in this context.<sup>6</sup>

- [14] As regards the power to co-determine the structure of senior management (again paragraph 65), we would also invite the Commission to clarify whether a sufficient veto right regarding “*co-determination of the structure of senior management*” can only exist if the veto right attaches to the appointment or dismissal of all members of the senior management. In our experience, joint venture parents often agree that each parent has the right to propose a certain number of members of senior management, and will accept and vote for the person(s) proposed by the other parent(s). For example, the two parent entities of a joint venture with a board of four members may agree that each parent has the right to appoint two members (or propose two members for appointment). In the example at the end of paragraph 76, the Draft Notice appears to suggest that it is sufficient that each parent appoints certain positions of senior management.
- [15] Paragraphs 72-75 discuss the possibility of joint control arising on a *de facto* basis due to strong common interests between the minority shareholders (or a majority shareholder and minority shareholders). We agree that joint control will only “*very exceptionally*” (paragraph 72) exist on that basis. However, the paragraphs as currently drafted allow a rather broad interpretation of the “*strong common interests*” standard. In particular, the notion that “*each parent company provides a contribution to the joint venture which is vital for its operation*” (paragraph 73) lacks clear contours. Companies are rarely invited to participate in a joint venture if they cannot contribute anything that the other parent will view as “vital” in terms of financing, assets, technology, know-how, securing sufficient demand or otherwise. We appreciate that it may be difficult to define more precise criteria in the abstract, but in the interest of legal certainty would stress the need to apply the “*strong common interest*” rule only in highly exceptional cases.

### **Changes in the Quality of Control**

- [16] The proposition in paragraph 79 that “*a change in the quality of control, resulting in a concentration, occurs if there is a change between sole, negative or joint control*” appears overly broad. At a minimum, we do not see any reason to subject a change from positive to negative (sole) control to merger review.
- [17] We further urge the Commission to reconsider the proposal in paragraph 81 that changes from negative to positive sole control be treated as concentrations.

---

<sup>6</sup> Paragraph 64 suggests that one always has to look at “*the importance of this right in the context of the specific business of the joint venture*” while paragraph 69 states that “[i]n assessing the relative importance of veto rights, where there are a number of them, these rights should not be evaluated in isolation. On the contrary, the determination of whether or not joint control exists is based upon an assessment of these rights as a whole.”

- [18] First, negative (sole) control can only exist if the person or undertaking in question fulfils the condition of Article 3(2) ECMR, i.e. has the “*possibility of exercising decisive influence*” on the controlled undertaking. For (positive) sole control, the same “*possibility of exercising decisive influence*” is required and sufficient, so nothing changes. The wording of the ECMR appears to exclude the possibility that a person or undertaking that already has the possibility of exercising decisive influence on another undertaking again can acquire the possibility of exercising decisive influence over that same undertaking. This is different for changes between sole and joint control, where the number and identity of controlling undertakings changes.
- [19] Second, we are not convinced by the arguments proposed in [paragraph 81](#) to justify treating a change from negative to positive sole control as a concentration. In part, they are based on the proposition that such a change frees the controlling shareholder from the obligation “*to take into account the interests of the other shareholders*”. However, this contradicts the definition of negative control in [paragraph 57](#),<sup>7</sup> where the Draft Notice explains that “*...the shareholder exercising negative control does not have to take into account the interests of other shareholders.*”<sup>8</sup>
- [20] Third, a requirement to notify a change from negative to positive sole control risks raising problems in practice. Even if the Commission were to succeed to define the differences between the two forms of sole control with greater precision, the distinction will remain subtle and highly dependent on factual circumstances. Companies do not normally monitor on an ongoing basis whether their previous negative (sole) control may change to (positive) sole control. We submit that it is unreasonable to require such ongoing monitoring, especially because positive (sole) control can arise on a *de facto* basis without any structural or legal changes. For example, will a minority shareholder with a blocking minority and therefore negative (sole) control constantly have to observe the participation rate and voting behaviour at annual meetings to exclude that his minority may suddenly be viewed as conferring (positive) sole control under the standards set in [paragraph 53](#)? Will this shareholder have to notify a concentration if one other small shareholder has not attended the meeting for a certain number of consecutive years? If a minority shareholder persistently exercises his veto right to block strategic initiatives, and other shareholders ask him under what conditions he would be not be exercising his veto, does this constitute a change from negative to positive sole control?
- [21] Fourth, a notification requirement only makes sense for concentrations that can be expected typically or at least possibly to lead to a different substantive assessment. As far as we are aware, the Commission so far has not established principles of substantive assessment for situations of negative (sole) control that would differ from the assessment of (positive) sole control, nor for situations of changes from negative to positive sole control. We do not believe that it will be easy to do so. In fact, there could well be situations in which a minority shareholder can use its strategic veto rights more effectively than a majority shareholder exercising positive sole control,

---

<sup>7</sup> [Paragraph 83](#) contains a similar statement.

<sup>8</sup> This contradiction in any event should be resolved in the finalization stage of the Notice.

due to the additional obligations that national law may impose on the majority shareholder in order to protect minority shareholders.

### **Joint Ventures – the Concept of Full-Functionality**

- [22] Acquisition of joint control of an undertaking “*with market presence*” constitutes a concentration “*even if it should be envisaged that the acquired undertaking will no longer be full-function after the transaction*” (last sentence of [paragraph 88](#)). It would be helpful if the Notice clarified the criteria that determine whether an undertaking is deemed to have a “*market presence*” in this context.
- [23] [Paragraph 90](#) discusses whether full-functionality can arise if members of the joint venture’s day-to-day management are employees of the parents. From our experience, it is not infrequent that managers of newly created joint venture company come from the parent entities and continue to be employed by them even for considerable periods of time. [Paragraph 90](#) suggests that the long-term secondment of parent personnel can only lead to full-functionality if “*the joint venture is also free to engage its own employees or to obtain staff via third parties.*” The scope of this condition is not entirely clear. Can this condition not be satisfied if the parent entities have decided in advance that, for example, the CEO will come from a parent and continue to be employed by that parent but work exclusively for the joint venture? Is there a critical mass of key employees or managers with respect to which the joint venture must in principle be free in its hiring decisions (which in any event will often be subject to approval by the parents?). We submit that continued employment of personnel working for the joint venture by the parent entities (even on a long-term basis) should not automatically exclude full-functionality but be viewed as one factor among others for determining full-functionality.
- [24] As regards the joint venture’s purchases from the parents, we suggest to clarify in [paragraph 97](#) that the question of added value is not relevant if the joint venture to a significant extent is active in products not sourced from the parents and only complements its product range with products sourced from the parents (but without adding value to those products).
- [25] In [paragraph 101](#), the Draft Notice takes the view that full-functionality does not arise when the start of the joint venture’s operations depends on uncertain third-party decisions, such as the contract award in public tenders. In such cases, the creation of the joint company would not lead to a concentration, but the later award of the contract would. The implication appears to be that joint ventures cannot be notified in these situations until the third-party decision has been taken. In our view, excluding the possibility of notification would not constitute sound policy.
- [26] First, for reasons of legal and commercial certainty, the party awarding the contract often will only accept unconditional bids, which joint ventures that require subsequent merger control review are unable to extend. A rule that excludes notification before the contract has been awarded risks excluding joint ventures from such projects in practice.

- [27] Second, deferring the point in time at which a joint venture can be notified to the Commission may create tensions with Member State merger control regimes. For example, German merger control law applies to the creation of joint ventures regardless of their full-functionality. A German merger filing therefore may be required before the contract is awarded. Or would the Commission avoid such tensions by establishing definitive jurisdiction in these circumstances at the time of first notification to a competition authority, thus leading to Member State jurisdiction and foreclosing subsequent EC jurisdiction (in parallel to the explanations on turnover in paragraph 148)? This would require clarification in the Notice.
- [28] We submit that allowing notification on the basis of a good faith intention to implement the joint venture in case the contract is awarded constitutes the better policy choice, as it avoids the above-mentioned practical and legal complications. In our view, it is also in line with the recast Merger Regulation, which for all concentrations allows notification on a good faith basis, even if it is uncertain at the time of notification whether the transaction will be implemented (Article 4(1)(2) ECMR). As the Draft Notice does not refer to any cases in this context, it would appear that the standard suggested here would not deviate from past Commission practice. Finally, we do not believe that allowing a notification on a good faith intention would significantly increase the Commission's workload, as many joint ventures of this type will be for the construction of specific projects without subsequent operation and therefore do not constitute full-function joint ventures under paragraph 100.

### **Joint Ventures - Changes in the Activities of the Joint Venture**

- [29] In this chapter of the Draft Notice, the Commission discusses whether changes in the activities of an existing joint venture can lead to a new concentration. In this context, we first propose to clarify the last sentence of paragraph 102 to say that the requirement to qualify as a concentration in its own right applies to both, the transfer of assets and acquisitions of the whole or part of another undertaking.<sup>9</sup>
- [30] More fundamental are our concerns regarding paragraph 103, which describes the circumstances under which the enlargement of a joint venture can lead to a new concentration even without an asset transfer from the parents.
- [31] First, it is not clear what constitutes an “*enlargement of the joint venture*”. It appears that the Commission envisages situations in which the joint venture becomes active in additional product or services markets (compare paragraph 102, referring to “*enlarge the joint venture's activities*”), but not situations of increase in size (e.g., increasing production capacity) or broadening of the geographic scope of the joint venture (e.g.,

---

<sup>9</sup> The current text reads: “...*the transfer of additional assets from the parent to the joint venture or the acquisition of the whole or part of another undertaking that would, considered in isolation, qualify as concentration as explained in point 22 of this Notice.*” The proposed new text reads: “...*the transfer of additional assets from the parent to the joint venture or the acquisition of the whole or part of another undertaking, if such transfer or acquisition would, considered in isolation, qualify as concentration as explained in point 22 of this Notice.*”

start selling in the new Member States). If so, this should be said explicitly or stated otherwise.

- [32] Second, we are concerned that the joint venture's expansion into new product or services markets will in many instances satisfy the two conditions set out in paragraph 103 and therefore regularly be treated as a new concentration. The first condition, i.e. that "*the enlargement would qualify as the creation of a full function joint venture when considered in isolation*" apparently requires a hypothetical assessment based on the assumption that the joint venture does not exist for the other products. However, on that assumption, it is difficult to see how the start of production, marketing and distribution of a (new) product would fall outside this condition. The second condition, i.e. that "*there are elements that demonstrate that the parent companies are in fact the real players behind this operation*" equally appears to be fulfilled in most cases. By definition, the parent entities decide the joint venture's strategy (otherwise the joint venture would not be jointly controlled), and entering a new product market often constitutes a strategic decision. Accordingly, the parent entities will normally have a "*significant involvement ... in the initiation, organisation and financing of the operation*" and therefore apparently be considered the "*real players*" behind the operation (paragraph 103 last sentence).
- [33] We do not see any need for such a sweeping new rule. It is an axiom of EC competition law that internal growth as such is not subject to regulatory scrutiny, and it is not apparent why joint ventures should be treated differently. The only conceivable concern could be that a joint venture that outgrows its originally intended scope may give rise to coordination between the parent companies, whereas such coordination appeared unlikely given the joint venture's original scope. But such cases could easily be captured by applying Article 81 EC. The original merger clearance would cover only the joint venture as originally notified, and thus any Article 2(4) analysis it may contain would not be determinative for analyzing the expanded joint venture. We believe that such situations are far too rare to justify an *ex-ante* filing requirement, in particular since the Merger Regulation's turnover calculation rules already catch many joint ventures of minor importance in the first place.
- [34] Furthermore, in our view, it is unrealistic to expect that companies will monitor whether they meet the conditions of paragraph 103 each time they decide that their joint venture start a new product. For example, if the joint venture is active in ten chemical products and the parents decide to add an additional product to the portfolio, we do not believe that management would consult in-house or external lawyers and ask for a review of merger control implications. The analogy that paragraph 103 draws to paragraph 208 (acquisition by the joint venture of another company) is not compelling as in the latter situation involves a structural change on which companies will normally consult inhouse or external counsel.
- [35] The explanations in paragraph 104 raise similar concerns, notably to the extent they require notification of an existing joint venture that previously lacked full-functionality because it mainly supplied its parents but then increases market sales and meets the full-functionality criteria of paragraphs 94-96. Paragraph 104 thus

would require joint ventures to constantly assess the proportion of sales to their parents.

- [36] We suggest that the Commission review its position on the two rules in paragraph 103 and 104. In our view, their deletion would be in the interest of legal certainty.

### **Community Dimension – Calculation of Turnover**

- [37] As regards Community dimension, we limit our comments to paragraphs 143 and 144. Under certain conditions, the Draft Notice proposes, for purposes of calculating turnover under the ECMR, to use non-final (instead final audited) accounts and to require non-EU companies with different accounting standards to restate their accounts in line with Community standards. Obviously, the consequence can be that transactions without Community dimension on the basis of “normal” accounts gain a Community dimension on the basis of non-final or restated accounts.
- [38] The Draft Notice states that the Commission “*may decide*” (last sentence of paragraph 143) or “*may consider it necessary*” (paragraph 144) to resort to the use of non-audited or restated accounts. We are concerned about the degree of legal uncertainty that this terminology creates. In particular, it would appear inappropriate for the Commission to challenge a transaction for which the parties correctly and in good faith had determined on the basis of their normal audited accounts that the concentration lacks Community dimension.
- [39] We appreciate that the Commission likely has in mind situations where there is discussion about Community dimension for a transaction that has been notified to the Commission or Member State authorities, or where the Commission otherwise gains knowledge of a transaction before its implementation. If this were correct, we would invite the Commission to explicitly state that the Commission can only resort to non-final or restated accounts in those instances.

\* \* \* \* \*