Working Party No. 3 on Co-operation and Enforcement

DEFINITION OF TRANSACTION FOR THE PURPOSE OF MERGER CONTROL REVIEW

-- European Union --

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1. Introduction

Under the EU merger control system, the concept of "concentration" plays a key role in determining whether a transaction requires notification to and approval from the European Commission prior to its implementation.

The legal basis for the concept of concentration is Article 1 of Regulation (EC) No 139/2004 ("the Merger Regulation"), which provides that the EU rules on merger control apply to transactions that satisfy two conditions. First, the proposed transaction must constitute a 'concentration' within the meaning of Article 3 of the Merger Regulation. Second, the concentration must have a 'Union dimension', meaning that the turnover thresholds set out in Article 1 of the Merger Regulation are met.

The Commission's Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 ("the Notice") provides comprehensive guidance on the interpretation of the concept of concentration. The Notice contains many examples and references to the Commission's enforcement experience in this regard.

This note aims primarily at providing an overview of the concept of 'concentration'/acquisition of control under the Merger Regulation. Issues relating to joint ventures and the acquisition of assets are addressed in this context. The Note also briefly addresses issues relating to non-controlling minority shareholdings, a topic in relation to which DG Competition had submitted a detailed note in the context of discussions of the 2008 WP3 Roundtable on Minority Shareholdings.

2. The concept of concentration

The concept of concentration under the Merger Regulation is intended to relate to operations which bring about a lasting change in the structure of the market. Indeed, in terms of Article 3(1) of the Merger Regulation, a concentration only covers operations where a change of control in the target business occurs on a lasting basis. Because the test in Article 3 is centred on the concept of control, the existence of a concentration is to a great extent determined by qualitative rather than quantitative criteria.

Article 3(1) of the Merger Regulation defines two categories of concentrations:

- those arising from a merger between previously independent undertakings;
- those arising from an acquisition of control.

2.1 Mergers between previously independent undertakings

A merger within the meaning of Article 3(1)(a) of the Merger Regulation occurs when two or more independent undertakings amalgamate into a new undertaking and cease to exist as separate legal entities. A merger may also occur, as is more often the case, when an undertaking is absorbed by another, the latter retaining its legal identity, while the former ceases to exist as a legal entity.

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1. OJ L 24 of 29 January 2003
2. OJ C 95/1 of 16 April 2008
8. Finally, a merger within the meaning of Article 3(1)(a) may occur where, in the absence of a legal merger, the combining of the activities of previously independent undertakings results in the creation of a single economic unit. This may arise in particular where two or more undertakings, while retaining their individual legal personalities, establish contractually a common economic management or the structure of a dual listed company. If this leads to a de facto amalgamation of the undertakings concerned into a single economic unit, the operation is considered to be a merger.

2.2 Acquisition of control

2.2.1 Concept of control

- Person or undertaking acquiring control

Article 3 (1)(b) of the Merger Regulation provides that a concentration occurs in the case of an acquisition of control. Such control may be acquired by one undertaking acting alone, or by several undertakings acting jointly.

Control is normally acquired by persons or undertakings which are the holders of the rights or are entitled to rights conferring control under the contracts concerned (Article 3(3)(a)). Specific issues may arise in the case of acquisitions of control by investment funds. It is Commission policy to analyse structures involving investment funds on a case-by-case basis.

- Means of control

Control is defined by Article 3(2) of the Merger Regulation as the possibility of exercising decisive influence on an undertaking. It is therefore not necessary to show that the decisive influence is or will be actually exercised. However, the possibility of exercising that influence must be effective. Article 3(2) further provides that the possibility of exercising decisive influence on an undertaking can exist on the basis of rights, contracts or any other means, either separately or in combination, and having regard to the considerations of fact and law involved. A concentration therefore may occur on a legal or a de facto basis, may take the form of sole or joint control, and extend to the whole or parts of one or more undertakings (cf. Article 3(1)(b)).

Whether an operation gives rise to an acquisition of control therefore depends on a number of legal and/or factual elements. The most common means for the acquisition of control is the acquisition of shares, possibly combined with a shareholders' agreement in cases of joint control, or the acquisition of assets.

Control can also be acquired on a contractual basis. In order to confer control, the contract must lead to a similar control of the management and the resources of the other undertaking as in the case of acquisition of shares or assets. In addition to transferring control over the management and the resources, such contracts must be characterised by a very long duration. Only such contracts can result in a structural change in the market.

Furthermore, control can also be established by any other means. Purely economic relationships may play a decisive role for the acquisition of control. In exceptional circumstances, a situation of economic dependence may lead to control on a de facto basis where, for example, very important long-term supply agreements or credits provided by suppliers or customers, coupled with structural links, confer decisive influence.
Finally, there may be an acquisition of control even if it is not the declared intention of the parties or if the acquirer is only passive and the acquisition of control is triggered by action of third parties.

- **Object of control**

  The Merger Regulation provides in Article 3(1)(b), (2) that the object of control can be one or more, or also parts of, undertakings which constitute legal entities, or the assets of such entities, or only some of these assets. The acquisition of control over assets can only be considered a concentration if those assets constitute the whole or a part of an undertaking, i.e. a business with a market presence, to which a market turnover can be clearly attributed.

  The transfer of a client base of a business can fulfil these criteria if this is sufficient to transfer a business with a market turnover. A transaction confined to intangible assets such as brands, patents or copyrights may also be considered to be a concentration if those assets such as brands, patents or copyrights may also be considered to be a concentration if those assets constitute a business with a market turnover. In any case, the transfer of licenses for brands, patents or copyrights without additional assets, can only fulfil these criteria if the licenses are exclusive at least in a certain territory and the transfer of such licenses will transfer the turnover-generating activity. For non-exclusive licenses it can be excluded that they may constitute on their own a business to which a market turnover is attached.

  Specific issues arise in cases where an undertaking outsources in-house activities, such as the provision of services or the manufacturing of products, to a service provider. Cases of simple outsourcing do not involve any transfer of assets or employees to the outsourcing service suppliers. It is usually the case that any assets or employees are retained by the customer.

  The situation may be different if the outsourcing service supplier, in addition to taking over a certain activity which was previously provided internally, is transferred the associated assets and/or personnel. A concentration only arises in these circumstances if the assets constitute the whole or part of an undertaking, i.e. a business with access to the market.

  If the assets transferred do not allow the purchaser to at least develop a market presence, it is likely that they will be used only for providing services to the outsourcing customer. In such circumstances, the transaction will not result in a lasting change in the market structure and the outsourcing contract is again similar to a service contract. The transaction will not constitute a concentration.

- **Change of control on a lasting basis**

  Article 3(1) of the Merger Regulation defines the concept of a concentration in such a manner as to cover operations only if they bring about a lasting change in the control of the undertakings concerned and in the structure of the market. The Merger Regulation therefore does not deal with transactions resulting only in a temporary change of control.

  The question whether an operation results in a lasting change in the market structure is also relevant for the assessment of several operations occurring in succession, where the first transaction is only transitory in nature.
• **Internal restructuring**

A concentration within the meaning of the Merger Regulation is limited to changes in control. An internal restructuring within a group of companies does not constitute a concentration. This applies for example to increases in shareholdings not accompanied by changes of control or to restructuring operations such as a merger of a dual listed company into a single legal entity or a merger of subsidiaries. A concentration could only arise if the operation leads to a change in the quality of control of one undertaking and therefore is no longer purely internal.

### 2.2.2 Sole control

9. Sole control is acquired if one undertaking alone can exercise decisive influence on an undertaking. Two general situations in which an undertaking has sole control can be distinguished. First, the solely controlling undertaking enjoys the power to determine the strategic commercial decisions of the other undertaking. This power is typically achieved by the acquisition of a majority of voting rights in a company. Second, a situation also conferring sole 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 (the so-called negative sole control).

**De jure sole control**

Sole control can be acquired on a *de jure* and/or *de facto* basis. It is normally acquired on a legal basis where an undertaking acquires a majority of the voting rights of a company. In the absence of other elements, an acquisition which does not include a majority of the voting rights does not normally confer control even if it involves the acquisition of a majority of the share capital. Where the company statutes require a supermajority for strategic decisions, the acquisition of a simple majority of the voting rights may not confer the power to determine strategic decisions, but may be sufficient to confer a blocking right on the acquirer and therefore negative control.

Even in the case of a minority shareholding, sole control may occur on a legal basis in situations where specific rights are attached to this shareholding. These may be preferential shares to which special rights are attached enabling the minority shareholder to determine the strategic commercial behaviour of the target company, such as the power to appoint more than half of the members of the supervisory board or the administrative board. Sole control can also be exercised by a minority shareholder who has the right to manage the activities of the company and to determine its business policy on the basis of the organisational structure.

**De facto sole control**

A minority shareholder may also be deemed to have sole control on a *de facto* basis. This is in particular the case where the shareholder is highly likely to achieve a majority at the shareholders' meetings, given the level of its shareholding and the evidence resulting from the presence of shareholders in the shareholders' meetings in previous years. Based on the past voting pattern, the Commission will carry out a prospective analysis and take into account foreseeable changes of the shareholders' presence which might arise in future following the operation. The Commission will further analyse the position of other shareholders and assess their role. Criteria for such an assessment are in particular whether the remaining shares are widely dispersed, whether other important shareholders have structural, economic or family links with the large minority shareholder or whether other shareholders have a strategic or a purely financial interest in the target company; these criteria will be assessed on a case-by-case basis. Where, on the basis of its shareholding, the historic voting pattern at the shareholders' meeting and the position of
other shareholders, a minority shareholder is likely to have a stable majority of the votes at the shareholders' meeting, then that large minority shareholder is taken to have sole control.

Apart from the acquisition of sole control on the basis of voting rights, as indicated in section 1.2 above, sole control may also be acquired by other means, such as by way of purchase of assets or by contract.

2.2.3 Joint control

10. Joint control exists where two or more undertakings or persons have the possibility of exercising decisive influence over another undertaking. Decisive influence in this sense normally means the power to block actions which determine the strategic commercial behaviour of an undertaking. Unlike sole control, which confers upon a specific shareholder the power to determine the strategic decisions in an undertaking, joint control is characterized by the possibility of a deadlock situation resulting from the power of two or more parent companies to reject proposed strategic decisions. As in the case of sole control, the acquisition of joint control can also be established on a de jure or de facto basis.

11. The clearest form of joint control exists where there are only two parent companies which share equally the voting rights in the joint venture. In this case, it is not necessary for a formal agreement to exist between them. However, where there is a formal agreement, it must be consistent with the principle of equality between the parent companies.

12. Joint control may exist even where there is no equality between the two parent companies in votes or in representation in decision-making bodies or where there are more than two parent companies. This is the case where minority shareholders have additional rights which allow them to veto decisions which are essential for the strategic commercial behaviour of the joint venture. These veto rights must be related to strategic decisions on the business policy of the joint venture. They must go beyond the veto rights normally accorded to minority shareholders in order to protect their financial interests as investors in the joint venture.

13. Veto rights which confer joint control typically include decisions on issues such as the budget, the business plan, major investments or the appointment of senior management. The acquisition of joint control, however, does not require that the acquirer has the power to exercise decisive influence on the day-to-day running of an undertaking. The crucial element is that the veto rights are sufficient to enable the parent companies to exercise such influence in relation to the strategic business behaviour of the joint venture. Moreover, it is not necessary to establish that an acquirer of joint control of the joint venture will actually make use of its decisive influence. The possibility of exercising such influence and, hence, the mere existence of the veto rights, is sufficient.

14. Even in the absence of specific veto rights, two or more undertakings acquiring minority shareholdings in another undertaking may obtain joint control. This may be the case where the minority shareholdings together provide the means for controlling the target undertaking. This means that the minority shareholders, together, will have a majority of the voting rights; and they will act together in exercising these voting rights. This can result from a legally binding agreement to this effect, or it may be established on a de facto basis.

15. The legal means to ensure the joint exercise of voting rights can be in the form of a (jointly controlled) holding company to which the minority shareholders transfer their rights, or an agreement by which they undertake to act in the same way (pooling agreement).

16. Very exceptionally, collective action can occur on a de facto basis where strong common interests exist between the minority shareholders to the effect that they would not act against each other in
exercising their rights in relation to the joint venture. In the absence of strong common interests, the possibility of changing coalitions between minority shareholders will normally exclude the assumption of joint control.

2.3 Changes in the quality of control

17. The Merger Regulation covers operations resulting in the acquisition of sole or joint control, including operations leading to changes in the quality of control. First, such a change in the quality of control, resulting in a concentration, occurs if there is a change between sole and joint control. Second, a change in the quality of control occurs between joint control scenarios before and after the transaction if there is an increase in the number or a change in the identity of controlling shareholders.

18. However, there is no change in the quality of control if a change from negative to positive sole control occurs. Such a change affects neither the incentives of the negatively controlling shareholder nor the nature of the control structure, as the controlling shareholder did not necessarily have to cooperate with specific shareholders at the time when it enjoyed negative control.

19. In any case, mere changes in the level of shareholdings of the same controlling shareholders, without changes of the powers they hold in a company and of the composition of the control structure of the company, do not constitute a change in the quality of control and therefore are not a notifiable concentration.

20. Two categories of changes in the quality of control can be distinguished: first, an entrance of one or more new controlling shareholders irrespective of whether or not they replace existing controlling shareholders and, second, a reduction of the number of controlling shareholders.

21. An entry of new controlling shareholders leading to a joint control scenario can either result from a change from sole to joint control, or from the entry of an additional shareholder or a replacement of an existing shareholder in an already jointly controlled undertaking.

22. A move from sole control to joint control is considered a notifiable operation as this changes the quality of control of the joint venture.

23. The entry of a new shareholder in a jointly controlled undertaking — either in addition to the already controlling shareholders or in replacement of one of them — also constitutes a notifiable concentration, although the undertaking is jointly controlled before and after the operation. First, also in this scenario there is a shareholder newly acquiring control of the joint venture. Second, the quality of control of the joint venture is determined by the identity of all controlling shareholders. It lies in the nature of joint control that, since each shareholder alone has a blocking right concerning strategic decisions, the jointly controlling shareholders have to take into account each other's interests and are required to cooperate for the determination of the strategic behaviour of the joint venture.

24. A reduction in the number of controlling shareholders constitutes a change in the quality of control and is thus to be considered as a concentration if the exit of one or more controlling shareholders results in a change from joint to sole control. Where the operation involves a reduction in the number of jointly controlling shareholders, without leading to a change from joint to sole control, the transaction will normally not lead to a notifiable concentration.

2.4 Joint ventures – the concept of full-functionality

25. Article 3(1)(b) of the Merger Regulation provides that a concentration shall be deemed to arise where control is acquired by one or more undertakings of the whole or parts of another undertaking. The
new acquisition of another undertaking by several jointly controlling undertakings therefore constitutes a concentration under the Merger Regulation. As in the case of the acquisition of sole control of an undertaking, such an acquisition of joint control will lead to a structural change in the market even if, according to the plans of the acquiring undertakings, the acquired undertaking would no longer be considered full-function after the transaction (e.g. because it will sell exclusively to the parent undertakings in future).

26. Article 3(4) of the Merger Regulation provides in addition that the creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity (so called full-function joint ventures) shall constitute a concentration within the meaning of the Merger Regulation. The full-functionality criterion therefore delineates the application of the Merger Regulation for the creation of joint ventures by the parties, irrespective of whether such a joint venture is created as a ‘greenfield operation’ or whether the parties contribute assets to the joint venture which they previously owned individually. In these circumstances, the joint venture must fulfil the full-functionality criterion in order to constitute a concentration.

27. The fact that a joint venture may be a full-function undertaking and therefore economically autonomous from an operational viewpoint does not mean that it enjoys autonomy as regards the adoption of its strategic decisions. Otherwise, a jointly controlled undertaking could never be considered a full-function joint venture and therefore the condition laid down in Article 3(4) would never be complied with. It is therefore sufficient for the criterion of full-functionality if the joint venture is autonomous in operational respect.

28. The full function character essentially means that a joint venture must operate on a market, performing the functions normally carried out by undertakings operating on the same market. In order to do so the joint venture must have a management dedicated to its day-to-day operations and access to sufficient resources including finance, staff, and assets (tangible and intangible) in order to conduct on a lasting basis its business activities within the area provided for in the joint-venture agreement.

29. A joint venture is not full-function if it only takes over one specific function within the parent companies' business activities without its own access to or presence on the market. This is the case, for example, for joint ventures limited to R&D or production. Such joint ventures are auxiliary to their parent companies' business activities. This is also the case where a joint venture is essentially limited to the distribution or sales of its parent companies' products and, therefore, acts principally as a sales agency. However, the fact that a joint venture makes use of the distribution network or outlet of one or more of its parent companies normally will not disqualify it as ‘full-function’ as long as the parent companies are acting as agents of the joint venture.

30. As long as the purpose of the joint venture is limited to the acquisition and/or holding of certain real estate for the parents and based on financial resources provided by the parents, it will not usually be considered to be full function, as it lacks resources to operate independently. This has to be distinguished from joint ventures that are actively managing a real estate portfolio and who act on their own behalf on the market, which typically indicates full-functionality.

31. The strong presence of the parent companies in upstream or downstream markets is a factor to be taken into consideration in assessing the full-function character of a joint venture where this presence results in substantial sales or purchases between the parent companies and the joint venture. The fact that, for an initial start-up period only, the joint venture relies almost entirely on sales to or purchases from its parent companies does not normally affect its full-function character.
32. Where sales from the joint venture to the parent companies are intended to be made on a lasting basis, the essential question is whether, regardless of these sales, the joint venture is geared to play an active role on the market and can be considered economically autonomous from an operational viewpoint. In this respect the relative proportion of sales made to its parents compared with the total production of the joint venture is an important factor. For this purpose, it is to be demonstrated that the joint venture will supply its goods or services to the purchaser who values them most and will pay most and that the joint venture will also deal with its parents' companies at arm's length on the basis of normal commercial conditions.

33. In relation to purchases made by the joint venture from its parent companies, the full-function character of the joint venture is questionable in particular where little value is added to the products or services concerned at the level of the joint venture itself. In such a situation, the joint venture may be closer to a joint sales agency. However, in contrast to this situation where a joint venture is active in a trade market and performs the normal functions of a trading company in such a market, it normally will not be an auxiliary sales agency but a full-function joint venture.

34. The joint venture must be intended to operate on a lasting basis. The fact that the parent companies commit to the joint venture the resources described above normally demonstrates that this is the case. By contrast, the joint venture will not be considered to operate on a lasting basis where it is established for a short finite duration. A joint venture also lacks the sufficient operations on a lasting basis at a stage where there are decisions of third parties outstanding that are of an essential core importance for starting the joint venture's business activity.

35. The parents may decide to enlarge the scope of the activities of the joint venture in the course of its lifetime. This will be considered as a new concentration that may trigger a notification requirement if this enlargement entails the acquisition of the whole or part of another undertaking from the parents that would, considered in isolation, qualify as a concentration.

36. A concentration may also arise if the parent companies transfer significant additional assets, contracts, know-how or other rights to the joint venture and these assets and rights constitute the basis or nucleus of an extension of the activities of the joint venture into other product or geographic markets which were not the object of the original joint venture, and if the joint venture performs such activities on a full-function basis.

2.5 Exceptions

37. Article 3(5) of the Merger Regulation sets out three exceptional situations where the acquisition of a controlling interest does not constitute a concentration under the Merger Regulation.

38. First, the acquisition of securities by companies whose normal activities include transactions and dealing in securities for their own account or for the account of others is not deemed to constitute a concentration if such an acquisition is made in the framework of these businesses and if the securities are held on only a temporary basis (Article 3(5)(a)). In order to fall within this exception a number of requirements must be fulfilled.

39. Second, there is no change of control, and hence no concentration within the meaning of the Merger Regulation, where control is acquired by an office-holder according to the law of a Member State relating to liquidation, winding-up, insolvency, cessation of payments, compositions or analogous proceedings (Article 3(5)(b)).

40. Third, a concentration does not arise where a financial holding company within the meaning of Article 5(3) of the Council Directive 78/660/EEC (99) acquires control.
41. The exceptions do not apply to typical investment fund structures. According to their objectives, these funds usually do not limit themselves in the exercise of the voting rights, but adopt decisions to appoint the members of the management and the supervisory bodies of the undertakings or to even restructure those undertakings.

3. Changes in the merger regime

42. Although minority shareholdings may impact the substantive competitive assessment of a merger case (including the assessment of possible remedies), the acquisition of minority shareholdings may only be directly assessed under EU merger control rules to the extent that the holding confers 'control' of the target business.⁴

43. Established economic theory and the Commission's experience in reviewing acquisitions of control, as well as the experience of other jurisdictions with merger control regimes which cover acquisitions of non-controlling stakes, indicate that significant harm to competition and consumers can occur from acquisitions non-controlling minority shareholdings.

44. Under the Merger Regulation, the Commission has currently only the possibility to take pre-existing minority shareholdings into account if it is competent to analyse the effects of a separate acquisition of control. If, however, the acquisition of the minority stake had succeeded the acquisition of control, the Commission would have had no competence under the Merger Regulation to deal with the competition concerns arising.

45. Although after more than 20 years in force, the basic features of the EU merger control system are well proven, the Commission services responsible for Competition are currently reflecting on a possible review of the Merger Regulation particularly with a view to covering the acquisition of non-controlling minority shareholdings so as to give the Commission the possibility to investigate and, if necessary, intervene against anti-competitive structural links.

46. As far as the selection of cases involving acquisitions of minority shareholdings and the procedure is concerned, different options could be envisaged. This could be done by extending the current ex-ante notification system to acquisitions of non-controlling minority shareholdings. Alternatively, a selective system might be considered more appropriate. Under such a system, the Commission would be able to select cases of acquisitions of non-controlling minority shareholdings that are more likely to raise competition issues. Any reform to the Merger Regulation would need to strike the right balance between the need for effective competition enforcement and the need to keep regulatory burden for stakeholders at a reasonable level.

4. Conclusion

47. The concept of 'concentration' together with the turnover thresholds established in the Merger Regulation, are the basis of the Commission's merger review jurisdiction.

48. The Commission's Notice seeks to achieve a high level of transparency, legal certainty and predictability as to the concept of concentration under EU merger control rules. In this context, the Notice

⁴ In this regard it is pertinent to note that the European Court of Justice has confirmed that acquisitions of minority shareholdings not conferring effective control may be analysed under Articles 101 and 102 of the Treaty on the Functioning of the European Union ("TFEU"). See in particular Case 142 and 156/84 British American Tobacco Company Ltd and R.J. Reynolds Industries Inc. v EC of the European Communities, [1986] ECR 1899.
provides important insight into the types of acquisitions of shares, acquisitions of assets, as well as the types of joint ventures which are deemed to constitute concentrations in terms of the Merger Regulation.