Cross-border mergers in the EU: the Commission versus the Member States

[Work in Progress]

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Motivation and Overview

Investigate delegation – focusing on case studies where Member States have sought to assert jurisdiction over EC mergers or have sought to deter transborder mergers by the use of ex ante controls on investment

Overview

- Jurisdiction under the ECMR
- Why delegate – from the point of view of the Member States
- Brief historical context to the jurisdiction / delegation under the ECMR
- Case Studies
  - exclusivity cases – interference with the Commission's exclusive competence under ECMR
  - *ex ante* restrictions on investment contrary to EC law
- Conclude – drawing some insights from agency theory and reflecting on the future of delegation / jurisdiction under the ECMR

Jurisdiction under the ECMR

- Exclusive Community competence for concentrations having a “Community dimension”
  - bifurcation of authority – Member States have exclusive competence where no Community dimension

- Community dimension decided by reference to *quantitative* criteria (based on aggregate world wide and Community turnover thresholds of merging parties):
  - Qualified by the “two-thirds rule” – two thirds of Community turnover of all undertakings occur in one and the same Member State
  - Secondary (lower) thresholds for multi-jurisdictional mergers

- “Bright-line” jurisdiction subject to limited exceptions:
  - German clause/Dutch clause/request of parties
  - “Legitimate interests” – defensive only

Why delegate: a functional logic

- Principal-Agent theory – assumption that it is in the interests of principal(s) to delegate power, *i.e.,* it is "functional"
  - but other explanations possible for delegation, *e.g.,* policy learning, institutional isomorphism (consider accession states)
- Trade-off: that the benefits of delegation outweigh the costs, in particular:
  - loss of control, the potential problems of agency shirking and slippage and associated monitoring and compliance costs
- Problems arise where there is a divergence between the policy preferences of the principal(s) and the agent
  - delegation can be a mechanism of making credible policy commitments where the short- and long-term policy preferences of the principal(s) diverge
  - the level of autonomy will depend on the seriousness of the credibility problem (Majone)

Why delegate in the EC merger context?

Genral arguments:

- “one-stop shop” principle – mergers in the EU which might otherwise involve multiple filings can be notified to a supranational body having sole competence - time is of the essence
- “level playing field” – the same procedural and substantive norms are applied
- centralised control necessary compliment to liberalisation and the underlying logic of the internal market
- Member States are less likely to engage in strategic behaviour
- no Member State has a veto over mergers which are welfare enhancing in aggregate terms
- efficiency-enhancing mergers are less likely to be deterred

Why (not) delegate in the EC merger context?

From the principals' perspective:

Delegation:

- commitment problems (the incentive to cheat) between principals is too strong to rely on looser forms of co-operation
- capacity (consider the Dutch clause)
- "blame-shifting" from the Member State to the supranational level

Non-delegation:

- some mergers do not have trans-border effects and NCAs may have informational advantages
- need to retain some "levers" over industrial policy (two-thirds rule)
- subsidiarity / legitimacy

The historical background to the ECMR

Treaty of Rome did not contain provisions on merger control

- founding Member States did not have established merger laws themselves
- most mergers were between firms within Member States

Without a specific Treaty basis, how was it possible to reach agreement?

Making the case: EC Commission, *Memorandum on the Problems of Concentration in the Common Market*, 1966:

- highlighted the tensions between the emergence of "European-scale" firms and the need to protect the position of SMEs, whose viability would be threatened by excessive concentration of market power
- argued (controversially) that it had the power – under Article 82 – and the duty – under Article 3(1)(g) – to ensure that dominant firms through acquisitions did not distort further the single market.

The role of the Court

Case 6/72 *Continental Can v Commission* (1973, ECJ)

- contrary to the prevailing view, the Court upheld the Commission's assertion that Article 82 could apply to mergers

- requirement of pre-existing dominance and abuse (i.e., only applied to acquisitions of rivals by dominant firms)

- nor exclusive competence – a merger which was not prohibited under Article 82 could still be blocked under national law

Cases 142 and 156/84, *BAT and Reynolds v Commission (Philip Morris/Rothmans)* (1987, ECJ)

- confirmed that that Article 81 *may* apply to the acquisition by one undertaking of a minority shareholding in another – did not constitute anti-competitive behaviour in itself, but it might serve as a means to such an end.

- Application of Article 81 filled in many of the gaps under Article 82 – which required in particular that the acquiring firm had a pre-existing position of dominance in the relevant market

- The Commission applied Article 81 to two other mergers, notably to British Airways' acquisition of British Caledonian, where it won changes to the deal despite its having being cleared by the British competition authorities

EC Merger control by stealth?

Uncertainty over the scope of the Commission's competence over mergers – with an acquiescent Court – led to increasing pressure from business on governments to agree a deal at Community level:

- "Possibly…. the most important outcome of the case from the Commission's viewpoint was the likely effect of concentrating the minds of the more unwilling Member States, fearful of the use of the Philip Morris precedent to attack merges under Article [81]" (Goyder);
- "By a combination of luck and skill the Commission had managed to create a problem which the Council felt… could be eased only by passing the legislation it had previously refused to (seriously) consider" (Allen (1996): 171);
- EC Commission "fully exploited" such ambiguities in order to persuade Member States to return to the negotiating table to agree a new draft regulation (Cook and Kerse (2000): 4)

Paradox of legal (un)certainty

– the Commission / Court create legal uncertainty in one area in order to bring about a change of policy to promote legal certainty in another (related) area

The Negotiations

Time line

- First EC merger regulation proposed in 1973 – but received little support from Member States

- Further proposal followed in 1981, 1984, 1986, 1988 with adoption of the (old) ECMR in 1989 (jurisdictional rules supplemented in 1998)

- New ECMR adopted in 2004 – but no change to the thresholds

Disagreement between Member States centred on:

- the level of the jurisdictional thresholds / qualifications (but not apparently the use of quantitative criteria)

- the substantive criteria – public interest derogations

- mechanisms of oversight and control over the Commission – the ability of Member States to control, shape, delay merger decisions.

Getting the deal through

The level of the jurisdictional thresholds: UK and Germany

- world wide turnover x 25 1973 proposal, x 5 1988 proposal;
- qualification proposed in 1988 – no Community dimension where 75 per cent of Community turnover of each undertaking in one and the same Member State – forerunner to the two thirds rule

Public interest derogations

- insistence by France and Italy (later joined by Spain and Portugal)
- strongly opposed by Germany (later joined by UK)
- France compromised – legitimate interests clause adopted

Oversight mechanisms

- Commission insisted on the weakest form of oversight (Advisory Committee)
- support / opposition from Member States varied

Overview: Case Studies

- Explain the Legitimate interests clause (Article 21(4))

- Case studies on infractions of the exclusivity principle

  - the ability of Member States to modify / frustrate EC mergers, apparently ignoring the Commission's infringement findings
  - BSCH Champalimaud, Endesa, Polish Banks

- Case studies on "golden shares"

  - the challenge to the mere presence of *ex ante* restrictions on investment and the apparent willingness of Member States to maintain in force legislation contrary to EC law

The legitimate interests clause: Article 21(4)

Permits Member States to take appropriate measures in respect of legitimate interests, including: public security, media plurality and prudential rules

For other non-specified interests Member State must inform the Commission and "stand-still"

Legitimate interests circumscribed by a number of principles:

- defensive in nature – cannot be used to clear a merger prohibited by the Commission
- legitimate interests cannot be a matter which the Commission takes into account
- must be consistent with general principles (proportionality / legal certainty) and other principles of EC law (must be a justified restriction on any of the fundamental freedoms).

Article 21(4) does not need to be relied upon where the measure in question in not addressed to the merger, but rather concerns the "conduct of undertakings on the market" (cf. *EDF/London Electricity* (1999)).

Most interesting cases have concerned alleged infractions of the exclusivity principle under Article 21 and legitimate interests are used as a defence.

The first Article 21 infringement case: *BSCH/Champalimaud*

Background:

- Concerned a “strategic alliance” between the Portuguese financial group, **Champalimaud** (third largest financial institution in Portugal) and **Banco Santander Central Hispano (BSCH)** (largest bank in Spain) – 40% of Champalimaud for 1.6% of BSCH

- **Concentration with a Community dimension.**

- Champalimaud had a portfolio which included an insurance firm, **Mundial Confiança (MC),** which had significant interests in a number of Portuguese banks.

- Following nationalisation in 1975, MC was “re-privatised” in 1992.

- **Privatisation statute** provided the government with *inter alia* authority to limit the extent of foreign holdings in privatised firms and/or restricting the voting rights which attached to such holdings.

- Under these rules, **the Minister for Finance attempted to veto the deal.**

The first Article 21 infringement case: *BSCH/Champalimaud*

Time line

- June 1999: BSCH-Champalimaud announce deal
- June 1999: Ministerial veto, July 1999 partial suspension of voting rights
- Hostile bid for MC follows from “white knight” BCP – suspension of BSCH voting rights makes MC more vulnerable
- 9 September 1999: Commission announces formal initiation of infringement proceedings (Article 21)
- 10 October 1999: Re-election of Portuguese Government
- 3 November 1999: Commission announces application for interim measures.
- 10 November 1999: New Portuguese Finance Minister introduces modifications to the deal acceptable to the parties: BSCH would acquire MC, but then sell on to State owned bank, keeping MC’s interests in two Portuguese banks
- January 2000: New deal received clearance by Commission, Portugal assumes presidency of the Council

The first Article 21 infringement case: *BSCH/Champalimaud*

In heralding the outcome of this "test case", Mario Monti stressed the resolve of the Commission to "vigorously" defend its competence, not least to secure the degree of "legal security" necessary to facilitate cross-border mergers:

> "This [case] shows that European competition rules have an important role to play in the creation of a genuine single market. It should also serve as a lesson that Member States must not try and prevent the opening to non-nationals of the financial services sector. There have been few transnational mergers so far in this key sector for the single market. I did therefore consider it particularly important that an operation which does not cause competition concerns can go ahead."

Article 21 infringement proceedings abandoned, but Commission already instigated infringement proceeding against the privatisation legislation- Infringement proceedings upheld by the ECJ in June 2002

Portugal uses similar provisions in respect of cement firm, *Cimpor* in 2000 – bid abandoned as a result of Ministerial veto – Article 21 infringement decision upheld by the ECJ in June 2004.

The *Endesa* saga

Bid by Gas Natural for Endesa (both Spanish energy firms) cleared by Spanish authorities subject to modifications (Feb 2006)

Rival bid by E.ON cleared by Commission (April 2006)

Despite protestations of the Commission, Spanish energy regulator and Minister impose a number of conditions on the E.ON deal under legislation enacted shortly after E.ON announces bid:

- divestment requirements initially, but watered down by Minister requiring commitment to purchase Spanish coal
- not to alter the structure of the Endesa group
- to keep HQ and Board of Directors in Madrid
- requirement to maintain Endesa brand

April 2007, E.ON announce the withdrawal of its bid for Endesa.

Italian energy firm, Enel and Spanish construction firm Accionia – built up a stake in Endesa of 25% and 21% (respectively) -- announce bid for Endesa – includes friendly agreement with E.ON to split up Endesa's assets

Spanish energy regulator imposes similar conditions on bid…the saga continues…

Polish Banks

1998 / 1999 HVB (German) and UniCredito (Italian) acquire two banks (BPH and Paeko) being privatised by the Polish Government

Privatisation agreements contain non-compete clause, 10 years' duration

UniCredito/HVB merger approved by Commission (Oct 2005) – decision challenged by Poland (pending)

Polish Government instruct divestment of BPH by UniCredito/HVB (Jan 2006)

Commission begin infringement proceedings under Article 21 (March 2006)

Polish Government reach agreement with UniCredito/HVB

- divestment of nearly half BPH branches
- commitment not to make job cuts in Paeko-BPH before March 2008

The Commission pursues "golden shares"

The so-called golden share cases:

- Member States put in place *ex ante* measures under which they can control investment in and management of (normally) key strategic industries which have been privatised;
- the legal basis of such measures may be provided for in domestic legislation and/or in the privatised firms' articles of association (or equivalent).

Commission fears the presence of such instruments stifle intra-Community investment (1997 Communication), pre-emptive strategy to force the removal / repeal of golden shares

All but one case (Portugal) involve laws which are non-discriminatory

Several cases initiated by Commission against: *Italy* (decided 2000), *Portugal* (2002), *France* (2002), *Belgium* (2002), *Spain* (2003 cf. Endesa), *UK* (2003), *Netherlands* (2006) – all but Belgian case successful.

Infringement of free movement of capital: Article 56 EC

Article 56 EC prohibits “all restrictions on the free movement of capital”

Subject to exceptions:

- in particular, Member States may take measures justified on the grounds of public policy or public security

Even if an exception applied, the restriction must also be consistent with the “general principles” of EC law, in particular:

- proportional (no less restrictive measure)
- legal certainty

The Court's approach

Low standard of proof for restriction:

- even the most minor interference with the right is sufficient: any *ex ante* measure which may deter potential investment by imposing obligations on firms which do not coincide with their economic interests (*Netherlands* (2006))

Exceptions have been interpreted restrictively:

- strict interpretation – little margin of appreciation for Member States
- cannot go beyond "management of strategic assets" – must not otherwise restrict economic freedom (*Belgium* (2002))
- protecting national economic interests cannot constitute a valid justification (*Portugal*, 2002)
- guaranteeing security of energy supply generally can (*Belgium* (2002))
- the firms in question must offer public services / services in the general interest (*Spain* (2003) - not tobacco(!), commercial banking)

The Court's approach

Strict procedural requirements:

- opposition and **not** prior authorisation (*Portugal*, *Belgium*)
- strict time limits necessary (*Belgium*)
- discretion to intervene must be "tightly defined" otherwise effective judicial supervision not possible (*France* (2002))

Member States cannot argue that they are acting in a private capacity as shareholder where there is any legislative underpinning for the golden share (*UK* (2003))

Closing remarks

Clear that “crude” quantitative rules do not always result in an optimal allocation of cases between the supranational and national level

As is suggested by the legislative history of the ECMR, the delegation of powers to the Commission has from *the point of view of the Member States* always involved a trade-off between legal certainty and the political costs of delegation

Legal (un)certainty was “manufactured” by the Court’s interpretation of Articles 81 and 82

The Commission’s enforcement strategy against Member States (aided by an acquiescent Court) has significantly emasculated the national “levers” of control

Nevertheless, as Champalimaud, Cimpor, Endesa and Polish Banks cases demonstrate, Member States are willing to maintain unlawful *ex ante* measures and use them to secure concessions from merging parties, and even frustrate trans-border mergers

Serious consequences for the stability of EC merger control (consider enlargement)

Insights from agency theory

What is clear from the history of the ECMR is that Commission's jurisdiction has been hard fought over:

- The Commission's ability to further expand its jurisdiction will depend upon the extent to which Member States believe that their views and interests will be given greater credence and cases will be allocated according to a "centre of gravity" approach.

Agency theory tells us that delegation should be viewed as a process (not an event):

- In considering if and how to delegate, Principals (Member States) will take into account how the Agent (the Commission) has used the powers in question in the past;

- The mechanism of delegation (unanimity among multiple-principals) gives rise to the "joint-decision trap" (i.e., powers once delegated can only be withdrawn with unanimity);

- Likely, therefore, that Member States are going to particularly wary of further expansion of Commission competence.

Postscript

- In response to a number of energy sector mergers which, by virtue of the two-thirds rule, have escaped the Commission’s jurisdiction, Competition Commissioner, Neelie Kroes has argued for the removal of the rule on the basis that it “no longer reflects an optimal allocation of competence” between the national and Community level (*Memo to College of Commissioners*, 2005);