



## ***Consultation response***

**To: European Commission**

***On Commission Staff Working Document:***

**Towards More Effective EU Merger Control**

**From: Centre for Competition Policy (ESRC)  
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## Response to the Commission Staff Working Document

### “Towards more effective EU merger control”

#### Introduction

The European Commission has invited comments on a number of options for possible future improvements of the EU Merger Regulation. This brief submission focuses on the first of the options identified, which relates to non-controlling minority stakes, also known as structural links. These fall short of mergers that would currently be reviewable under EU merger control.

We first explain why we support the view that there is a ‘gap’ in existing merger control which needs filling. We then discuss how such a gap might best be filled, from a procedural perspective.

#### Economic issues: Why there is a ‘gap’ which needs filling

We strongly support the amendment of the Merger Regulation to enable the Commission to assess such minority shareholdings. (See Q1). This makes good economic sense, since such structural links can have very significant anti-competitive effects, as is set out in Annex 1 to the Commission Staff Working Document (“The Economic Annex”).

As set out in this Annex, it is possible to draw broad distinction between the potential competitive effects associated with purely *financial interest* and those that relate to *structural effects*, such as increased access to confidential information or a degree of corporate influence.<sup>1</sup> Financial effects are typically a weaker version of the competitive effects that would arise from full merger. By contrast, structural effects can potentially be even more serious than those arising from full merger. As such, merger concerns should be expected to arise more frequently where the partial acquisition facilitates information flows or corporate influence. Nonetheless, substantial concerns can still arise where there is financial interest only, as is evident from the US case *Primestar/ASkyB* (1998), described in Annex 2 to the Commission Staff Working Document (“Annex 2”).

While The Economic Annex provides an excellent overview of the existing economic literature, we believe a further distinction might usefully be made between two classes of structural effects that can arise from minority shareholdings; those that are ultimately profitable (or profit-neutral) for the partially acquired firm (*positive structural effects*) and

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<sup>1</sup> Note that we use the term ‘structural effects’ more narrowly than the Commission’s use of the term ‘structural links’ (which the Commission uses interchangeably with ‘minority shareholdings’). The latter embraces also what we call ‘financial interest’.

those that are ultimately unprofitable for the partially acquired firm (*negative structural effects*).

Where structural effects involve the acquirer changing the behaviour of the target firm, this will always work against the immediate self-interest of the target firm; if not, the firm would have behaved in this way anyway. However, in some cases, the structural effects may nevertheless ultimately be in the longer term interest of both firms. This may occur where the effect is to soften competition or facilitate collusion between them. In our terminology, most of the horizontal structural effects reviewed in the Economic Annex are positive in this sense; that is, there is a mutual benefit to the acquirer and the partially acquired firm.

Negative structural effects relate to situations in which the acquirer uses its minority shareholding in a way which ultimately harms the partially acquired firm. An especially serious form of negative structural effect, not discussed in the Economic Annex, relates to the situation where the acquirer uses its position to limit the competitive strategies available to the target firm, thereby weakening it as a competitive force. This could, for example, occur where the acquirer gains material influence over the outcome of the special resolutions, or even ordinary resolutions, which are needed to approve certain strategies, for example in relation to significant investments, raising capital, or engaging in mergers and acquisitions.

Negative structural effects are typically unlikely to be welcomed by the management or, more importantly, by the shareholders of the partially acquired firm. The possibility of negative structural effects will not usually arise in a full merger, because the incentives of the acquirer and target become aligned post-merger. By contrast, with a minority shareholding, the interests of the acquirer and the target can diverge substantially, on an ongoing basis, with the acquirer potentially gaining an advantage if the target can be made a less effective competitor. Where shareholdings are used strategically to damage a competitor, the economic effects are closer to those more typically analysed in exclusionary Article 102 cases than in merger cases. Furthermore, the anticompetitive effects are quite different to those of voluntary agreements investigated under Article 101, which are perhaps closer to positive structural effects. In our view, neither of these antitrust provisions is suitable for addressing the range of economic effects that arise in connection with some minority shareholdings.

Negative structural effects are not just a theoretical possibility. Such considerations underpinned the two recent UK minority shareholding cases that have resulted in remedies. As is described in Annex 2, the key concern in BSkyB/ITV (2007) was that BSkyB would be able to limit the strategies available to ITV, and thereby to reduce ITV's effectiveness as a competitor. Similar considerations lie at the heart of the Ryanair/Aer Lingus (2013) decision.

The Economic Annex also considers the issue of efficiency benefits, and highlights that a partial shareholding is less likely to deliver the synergies than might be achieved through full merger, such as rationalisation of avoiding cost duplication. While this is true, it should not be overlooked that there can be other benefits arising from partial shareholdings and other structural links. For example:

- Equity is a key form of finance. When seeking finance, companies (and especially small companies) may approach other companies in the same industry to purchase their equity. Because these other companies understand best the risks faced by the company seeking finance, they will often be willing to offer finance at a better rate than would be available from outside investors, who are less well informed. As such, minority shareholdings may reflect efficient capital-raising.
- Structural links may be an intrinsic part of a wider set of arrangements, where the other elements (such as IP licensing arrangements) may themselves give rise to efficiency benefits.

We note that these efficiencies cannot be expected to arise in cases of negative structural effects, which therefore raise a particular concern.

Finally, we consider that the substantive 'SIEC' test within the Merger Regulation (ie whether the transaction 'significantly impedes effective competition') is appropriate for assessing such structural links. (See Q2). In the context of minority shareholdings, it is especially important to retain a strong focus on the likely effect being significant/substantial.

Overall, there is a clearly identifiable gap in current EU competition law and it is appropriate to fill this gap by extending the scope of merger regulation.

#### **Procedural issues: How might this gap best be filled?**

It is clearly important that any widening of the Commission's remit be accompanied by procedural rules that are both practicable and proportionate; and which strike the right balance between enabling intervention in cases which do raise concerns without imposing undue burden on firms.

In this context, the following points are noteworthy:

- First, it is relatively rare in practice for non-controlling stakes to raise significant anticompetitive concerns. In the UK, where the authorities do have the powers to review structural links where they amount to 'material influence', such shareholdings have accounted for only around 5 per cent of all scrutinised mergers,

and over the past decade the two cases listed above have been the only ones requiring remedies.

- Second, there is no clear shareholding level at which concerns suddenly arise, and indeed they can occur at relatively low levels of shareholding. As is clear from the German figures provided in Annex 2, there are as many cases are prohibited that lie below the 25% quantitative notification threshold (11% of all prohibitions) as lie above this threshold (10% of all prohibitions). Likewise, in the UK, the stake in BSkyB/ITV (2007) was just 17.9% (and the Competition Commission required that this be reduced to 7.5%).

### *Choice of Basic Procedural System (Q3)*

Given the above, we believe it would be disproportionate to impose mandatory notification, or even transparency requirements, on a large scale and at a low threshold, given the burden this imposes on firms (and indeed authorities) compared to the relative rarity of concerns arising. However, it is also important that the authorities are able to assess relatively low levels of minority shareholding, given that substantial competition concerns can still arise.

On this basis, we can see significant merit in the UK fully *selective* self-assessment system. However, we would also support a *mixed* system which combined elements of the US and German systems, but under which the thresholds for jurisdiction and notification are set at different levels. Under our preferred mixed system:

- There would be a relatively high threshold for mandatory notification or transparency requirements (at, say, shareholdings above 25%, as in Germany).
- There would be a safe harbour for shareholdings below 10% which confer no decisive voting rights or board positions. (See Q7 – We would also propose this within a fully selective system).
- Between these levels, the authority would have jurisdiction to look at mergers, but there would be no mandatory notification, nor any transparency requirement.

We think this mixed option would strike an appropriate balance between reducing the risk that harmful mergers are missed, while reducing the burden on both firms and authorities arising from reviewing mergers which raise no concerns.

Given that structural links are much more easily remedied than full mergers, we also consider that it would be disproportionate to require a standstill provision for the acquisition of minority shareholdings. It is sufficient that they are reviewable retrospectively. (The only exception might be mischievous share purchases designed to

influence a rival's strategy at a delicate time, such as during proposed merger with a third party. However, we recognise that it may be hard to distinguish easily between mischievous and non-mischievous shareholdings and apply a standstill provision only to the former.)

#### *Information Requirements (Q4)*

In the *mixed* system set out above, the choice between mandatory notification and transparency requirements (above a certain threshold) is a delicate one. We see the as the key distinction that mandatory notification requires the authority to make a decision on the shareholding, whereas a transparency requirement simply alerts the authority to the shareholding, without formally requiring it to act.

On this basis:

- Mandatory notification provides parties with greater legal certainty, but at the likely cost of their having to provide substantially more information (probably as much as for the short form merger CO) in order to allow the authority to reach a decision with sufficient certainty, and also at the cost of the authority having to review this information and form a judgment.
- By contrast, transparency requirements could be kept very light, perhaps to as little as the parties' names, key activities and details of the transaction. (See Q4). The Commission would need to put in place a system for screening the information received, based on market intelligence, to enable it to identify those mergers most likely to raise concerns. Based on the UK's experience with such market intelligence work, we would expect this to require only limited extra resource. We believe that the OFT has fewer than two FTEs working in this area. It would almost certainly be cheaper (especially for parties) than the mandatory notification approach.

Overall, so long as the threshold is set relatively high (ie at least 25%), we do not necessarily feel that mandatory notification would be disproportionate. However, given the rarity of problematic cases arising, we believe light transparency requirements would be adequate.

#### *Definition of Structural Link (Q7)*

We recognise that financial interest on its own is less likely to raise substantial concerns than structural links which confer increased transparency of information between firms or a degree of corporate influence. Nevertheless, we consider it important that the authorities are able to address the full range of possible anti-competitive effects that can arise from minority shareholdings. As such, we consider it important that any jurisdictional test for 'structural link' incorporates financial interest considerations as well as control considerations. The UK test ('material influence') does not fit well with the financial interest element of the economic literature.

### *Voluntary Notification (Q8) and Time Limitation Period (Q9)*

A key difficulty with a selective system, whether or not it applies only beneath a specific threshold, is that it can be difficult for authorities to find out about transactions absent any form of transparency requirement. The UK has found that this can be a problem for full mergers, and the difficulties would be greater still for minority shareholdings.

This problem may not apply in the case of mergers giving rise to negative structural effects, such as Ryanair/Aer Lingus (2013), where the partially acquired firm is harmed through the minority shareholding. In such cases, the target firm might well be expected to see the shareholding as hostile, and to alert the authorities without any need for transparency requirements or mandatory notification. Unlike the situation with full merger (where authorities need to take care not to undermine the market for corporate control), we would expect authorities to take any such complaints from a target firm very seriously, especially where received not only from the target's management but also its other shareholders.

However, not all anti-competitive minority shareholdings will be hostile, and therefore there remains a risk that the authorities do not learn about potentially harmful cases in a timely manner in a selective system. This might militate in favour of not having any time limitation periods.

There are, however, counter-arguments. First, there may be benefits to be derived from the legal certainty resulting from a time limitation period having been passed. Second, there is also there is a risk that market conditions will change and that structural links which would have been considered acceptable at the time they were entered into may become anti-competitive in the new market context. While there may be some merit in intervention at this point, we do not think it would be appropriate or proportionate for authorities to be able to use merger rules as an ongoing regulatory tool in this way. We do not have such a provision for full mergers and for good reasons.

Given these opposing effects, our preference would be:

- First, that voluntary notification should be allowed. If firms are aware that the authority can come in *ex post* and review any minority shareholding (other than within the safe harbour), then they may well wish to gain legal certainty in potentially problematic cases, by requesting an early decision on the transaction. (See Q8).<sup>2</sup>

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<sup>2</sup> While allowing voluntary notification raises the theoretical risk that it might 'open the floodgates' in terms of notifications, it is far from clear that this would occur in practice. Given that minority shareholdings tend to be rather more easily reversible than full mergers, parties may feel less in need of legal certainty. Moreover, it is

- Second, that there should be a time limitation period for authority action against minority shareholdings, but that it should be relatively long (say, two years) in order to reduce the likelihood of anti-competitive structural links being missed. (See Q9). (We would also recommend a further proviso in the case of negative structural effects – see the section on game-playing below.)
- Third, that consideration should be given to the option of parties being able to make a voluntary transparency submission, in return for a shorter time limit for authority action. This would involve a lighter information requirement than voluntary notification, and would not require the Commission to make a formal decision, but would reduce the risk of the Commission missing mergers which potentially raise issues.

### *Minimising the risk of game-playing*

Whilst no system of merger control will ever be perfect, it is important to be mindful of the risk of game-playing by parties. A particular difficulty in the context of minority shareholdings is that gradually higher levels of shareholding and greater levels of control will be gradually more likely to give rise to a SIEC. So, for example, it must be possible that an authority might wish to clear a shareholding in a competitor of, say, 15% and no board representation, but nevertheless might find an SIEC if the same party increased its shareholding to 35% and had gained a board member.

Given this context, there are three possible ways in which parties might attempt to game any system of merger control covering minority shareholdings.

- First, parties might notify an early non-SIEC stake, as soon as the jurisdictional threshold has been passed, with a view to gaining a formal clearance decision. If the merger regime is designed as a ‘one shot’ system, so that the authority cannot then look at further increases in partial shareholding or control, this could restrict the ability of the authority to prevent a later anti-competitive increase in the structural link.
- Second, and related, parties might endeavour to engage in ‘salami-slicing’ with respect to the extent of structural link. For example, they might voluntarily notify an initial non-SIEC shareholding, wait for the relevant time limitation period to expire, raise the level of shareholding (or control), wait again, and then raise it again, etc.

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noteworthy that only 5% of mergers reviewed under the UK regime relate to minority shareholdings, even though voluntary notification is allowed under the UK regime.



This could give rise to a situation in which the final extent of structural link would have raised concerns but none of the increments alone constitute an SIEC.

- Third, a substantial shareholding in firm B may be acquired by firm A and held passively and benignly for several years before being used as a negative structural effect at a later date. For example, influence may be wielded only once firm B has become a strong competitor or when a potential acquisition by firm B would make it a stronger competitor. [Q9]

In respect of the first of these issues, we would recommend that the Commission give consideration, in cases where this may be a relevant concern, to providing conditional clearances, whereby the parties are required to ensure that no further increment occurs in terms of financial interest or control.

In respect of the second salami-slicing issue, we recommend that the Commission should retain the ability to review retrospectively the full extent of any structural links between any two parties, so long as the most recent increment occurred within the set time limitation period.

In respect of the third 'change of de facto influence' issue, we recommend that the Commission should retain the ability to review retrospectively the full extent of any structural links between any two parties if the shareholders of the partially acquired firm make a credible complaint.

#### *Residual issues*

We do not provide views on Questions 5 or 6 on Page 12 of the Commission Staff Working Paper, as we do not have specific expertise on these issues.

We would, however, be concerned by any suggestion that Member States alone could be relied on for assessing minority shareholdings, under their domestic merger laws. Where a transaction has an EU-wide dimension, we believe it is appropriate that the Commission should be in a position to review it. Moreover, the vastly prolonged process around Ryanair/Aer Lingus (2013) – whereby the UK had to wait until the Commission had reviewed the full merger before opening its own proceedings into the minority shareholding – provides strong support for the Commission being able to review minority shareholdings alongside decisive control issues.