Corporate Governance and Merger Control: How Control Rights Affect Merger Control Requirements

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More than 70 countries have now enacted merger control statutes, and the number continues to grow. Antitrust agencies worldwide now have jurisdiction to review, potentially delay, and block proposed transactions raising antitrust issues in their jurisdiction. One of the most recent entrant on the scene, the Anti Monopoly Bureau of the Ministry of Commerce (Mofcom) of the People's Republic of China, blocked one high-profile transaction and significantly altered several cross-border transactions since becoming effective in August 2008.[1]

The result of this proliferation is that mergers between multinational corporations frequently trigger merger control requirements in multiple jurisdictions. Yet, merger control regimes vary significantly on a range of important procedural issues. For example, while most merger control regimes require the parties to suspend closing of the transaction before receiving clearance (or under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR), the expiration of the HSR waiting period), some regimes, such as Brazil, allow the parties to close pending review. Similarly, while most countries impose a mandatory obligation on the parties to file transactions with their antitrust agencies, others, such as the U.K., make this a voluntary option.

Merger control regimes also vary significantly as to which transactions fall within their jurisdiction. The question of whether a transaction requires approval needs to be answered following the rules of each jurisdiction. By and large, this is a two-step analysis, where both steps must be met. The first step focuses on whether the transaction exceeds the jurisdictional thresholds. These thresholds are typically based on the revenues derived by the merging parties in each country of operation, their assets in these countries, or the market share held by the parties. Under the European Merger Control Regulation (EMCR), for example, the revenue thresholds are as follows: (1) the parties to a transaction (meaning the acquirer, or acquirers, and the target) must achieve combined revenues of more than € 5 billion worldwide, and (2) each of at least two parties to the transaction must have derived in excess of € 250 million in EU-wide revenues.[2] But that is just the first step of the analysis. Even if these revenue thresholds are exceeded, a filing is not required if the second step is not met.

The second step of the analysis—present in most merger control regimes (with the notable partial exception of the U.S.)—is a corporate governance question: whether the acquirer, or acquirers, will "acquire control" over the target? The definition of control, however, varies greatly, so much so that it is possible for companies to change hands entirely without it being an "acquisition of control" for merger control purposes under the ECMR and most merger control laws modeled on the ECMR. And no control means no filing obligation and no antitrust agency in the critical path to closing. Therefore, as companies and corporate lawyers structure term sheets, shareholder agreements and other operating agreements, it is important to fully grasp the impact of their corporate governance choice on the merger control process. This is even more important when drafters of these corporate agreements are used to the U.S. analysis under the HSR Act, which does not require a change of control.[3]

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The ECMR Definition of Control

A filing at the European Commission is only required if there is a proposed change of control. One or more buyers must propose to acquire control over the target.[4] The definition of control is relatively simple, but has counter-intuitive consequences. Control means either one of three things:

1. Acquisition of more than 50% of the voting stock;[5] or
2. "Acquisition" of more than 50% of the board seat representation; or
3. Veto power over "strategic commercial decision."

This is an alternative and not cumulative test. The definition of "strategic commercial decisions" becomes critically important in consortium deals in which no party acquires more than 50% of the voting stock, or more than 50% of board representation. In such circumstances, which are common in consortium deals, the question of whether one or more acquirer has veto over "strategic commercial decisions" will determine whether a filing is required.

The European Commission's Consolidated Jurisdictional Notice defines which rights confer control. First,

these rights "must go beyond the veto rights normally accorded to minority shareholders in order to protect their financial interest in the joint venture."[6] Second, these rights cover issues such as "the budget, the business plan, major investments or the appointment of senior management."[7] The Notice adds that "in order to acquire joint control, it is not necessary for a minority shareholder to have all the veto rights mentioned above. It may be sufficient that only some, or even such right, exists. Whether or not this is the case depends upon the precise content of the veto right itself and also the importance of this right in the context of the specific business of the joint venture."[8] So there is some flexibility for the Commission to determine, on a case-by-case basis, which of these rights confer control.

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Switching Majorities

But there is so much flexibility when the parties structure the transaction to exclude any such right. If no party proposes to acquire either (1) 50% of voting rights,[9] (2) 50% of board seats, or (3) veto right over strategic commercial decision, this is not an acquisition of control. Rather, this is a situation of potential "switching majorities" or "changing coalitions"[10] over which the European Commission cannot assert jurisdiction, regardless of whether the transaction raises substantive antitrust concerns.

For example, the joint acquisition of ContentGuard by Microsoft, Time Warner and Thomson escaped EC jurisdiction even though the Commission had raised concerns about the initial structuring of this acquisition. In 2004, Microsoft and Time Warner notified the European Commission of their proposed acquisition of ContentGuard from Xerox. The initial structuring of this acquisition gave Microsoft and Time Warner 48% of the voting rights in ContentGuard.[11] In addition, they entered into a shareholder agreement which gave them joint control over ContentGuard.[12] At the time, ContentGuard was one of the main digital rights managements (DRM) patent holders.[13] After an initial review, the European Commission opened an in-depth "second phase" investigation to assess whether the acquisition would have given Microsoft the ability to use ContentGuard's DRM technology in an anticompetitive manner.[14] Following this development, Microsoft and Time Warner altered their shareholder agreement and invited Thomson to join them in acquiring ContentGuard. This resulted in an acquisition of one-third of the equity by each party, with no significant veto rights. As a consequence, the European Commission no longer had jurisdiction over this transaction under the ECMR.

Germany and Austria

One of the keystones of the ECMR is one-stop shopping: if the European Commission has jurisdiction, the national competition agencies no longer have jurisdiction. And vice versa, if the Commission does not have jurisdiction, the parties need to assess whether their transaction requires notification with national competition agencies. This plays a role in consortium transactions, as a few EU Member States do not follow the ECMR's approach regarding switching majorities. The two most important exceptions are Germany and Austria. There, an acquisition of 25% of the stock of a company may require a filing.[15] In addition to this clear-cut rule, German law provides that a filing may be required upon "the exercise of competitively significant influence."[16]

The German Merger Control Agency (the Bundeskartellamt) has recently used this provision to block the acquisition of a 13.75% equity interest in a competitor.[17] In its decision, the Bundeskartellamt explained that it is sufficient for a finding of "competitively significant influence" that the target company and the acquirer be "intertwined in a way that severely limits competition and prevents them from acting as independent enterprises in the future."[18] Key facts in the Bundeskartellamt's analysis were: (i) the low attendance rate at shareholders' meetings of between 35–37% in the three years preceding the proposed transaction, (ii) the fact that there was no majority shareholder, (iii) the fact that the second largest shareholder held only 5% of the shares, and (iv) that the acquirer planned to obtain three (out of 12) seats in the Board of Directors.[19] The Bundeskartellamt also emphasized that according to the acquirer's own statements, the investment in the competing target company was "strategic" and not merely of a financial nature.[20]

China

Like the ECMR, the Chinese Anti-Monopoly Law provides for a mandatory pre-closing merger control regime. But the question of what constitutes an acquisition of control remains open. In January 2009, Mofcom issued a draft "Interim Regulation on Filing of Business Concentration." The definition of what constitutes "control" in this draft Interim Regulation potentially gives Mofcom the ability to review most minority acquisitions. Acquiring "control" means either (1) acquiring "more than 50% of voting shares or assets of other operators"; or (2) having the ability to (i) appoint at least one director or one "senior management personnel of other operators," (ii) veto the financial budget, (iii) run the operations, (iv) determine pricing, (v) veto material investment or (vi) veto

any other major management or operations decision. To the extent this provision remains in the final Regulation, this would constitute a significant difference between the Chinese and European approach to merger control.

Conclusion

The European and Chinese merger control rules show that understanding the intricacies of merger control regulations may be of use in the early stages of the drafting of operating agreements. In a time when time and financing constraints continue to pressure the merger and acquisition market, and as merger and acquisitions continue to cross borders, antitrust counsel versed in global merger control rules can provide early insight to the optimal corporate structure to get a deal through the merger control process as quickly as feasible.

Endnotes

1. Mofcom blocked Coca-Cola Co.'s proposed $2.4 billion acquisition of Huiyuan Co. and imposed conditions on several transactions including InBev's $52 billion acquisition of Anheuser-Busch, Mitsubishi Rayon's $1.6 billion acquisition of Lucite International, and Pfizer's $68 billion acquisition of Wyeth.
2. *See* Art. 2(1) ECMR *available at* http://ec.europa.eu/competition/mergers/legislation/legislation.html. The ECMR also provides for an alternate, smaller test: (1) Combined revenues of more than € 2.5 billion worldwide; (2) combined revenues of all the parties in each of at least three EU Member States above € 100 million; (3) combined revenues of each of at least two parties to the transaction in these three EU Member States must exceed € 25 million, and (4) and the EU-wide revenue of each of at least two parties to the transaction must exceed € 100 million.
3. Under the HSR Act, an acquisition that results in the acquiring person holding more than $65.2 million of the voting securities of another company may require a filing, even if the amount acquired represents a small percentage of the voting stock of the target.
4. *See* Art. Art. 3(1)(b) EMCR Art. 3(1)(a) further provides for merger review for transactions where two or more previously independent entities merge into one single entity.
5. Even the acquisition of less than 50% of the voting stock can result in the acquisition of control (and thus, the obligation to file), if such shareholding is likely to achieve a majority at the shareholders' meeting due to widely dispersed shares and limited shareholder attendance at shareholders' meetings, *see* European Commission, Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings [2008] C95/1, Para. 59. Recently, the European Commission imposed a fine of € 20 million on the electricity producer and retailer Electrabel for closing a transaction without prior approval because the European Commission took the position that Electrabel had acquired a minority shareholding that gave rise to control, and the transaction was thus notifiable to the European Commission; *see* Commission Press Release of 6 June 2009, IP/09/895.
6. Commission Consolidated Jurisdictional Notice, Para. 66.
7. Commission Consolidated Jurisdictional Notice, Para. 67.
8. *Id.*
9. *See* note 5 above.
10. *See* Commission Consolidated Jurisdictional Notice, Para. 80: "In the absence of strong common interests [...] the possibility of changing coalitions between minority shareholders will normally exclude the assumption of joint control. Where there is no stable majority in the decision-making procedure and the majority can on each occasion be any of the various combinations possible amongst the minority shareholders, it cannot be assumed that the minority shareholders (or a certain group thereof) will jointly control the undertaking. In this context, it is not sufficient that there are agreements between two or more parties having an equal shareholding in the capital of an undertaking which establish identical rights and powers between the parties, where these fall short of strategic veto rights. For example, in the case of an undertaking where three shareholders each own one-third of the share capital and each elect one-third of the members of the Board of Directors, the shareholders do not have joint control since decisions are required to be taken on the basis of a simple majority."
11. *See* Commission Press Release of 15 March 2005, IP/05/295.
12. *Id.*
13. *See* Commission Press Release of 25 August 2004, IP/04/1044.
14. *Id.*
15. Section 7(1)(No.3) of Austrian Cartel Act of 2005 and Section 37(1)(No.3a) of the German Act Against Restraints of Competition.
16. Section 37(1)(No.4) of the German Act Against Restraints of Competition.
17. Federal Cartel Office, Decision of 27 February 2008, B5-198/07—*A-TEC Industries AG / Norddeutsche Affinerie AG.*
18. *Id.* at 24.
19. *Id.* at 17–24.
20. *Id.* at 20. Critical of the Bundeskartellamt's decision, *see* Andreas Weitbreach/Georg Weidenbach, *Wettbewerblich erheblicher Einfluss auf börsennotierte Aktiengesellschaften*, 58 W.u.W. 788 (2008).

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