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The concept of control under the Merger Regulation

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1. INTRODUCTION

There is an upward trend in activities under the Merger Regulation. During the first four months of 1999 92 operations were notified to the Commission. This is an increase of 31 % compared to the same period of 1998¹. In 1998 the Commission adopted 238 final decisions under the Merger Regulation which means an increase of 66% compared to 1997². The Merger Regulation deals with transactions creating concentrations. In order to constitute a concentration a transaction must lead to a “change in control”. Lots of questions arise. What is control? Which rights are required to confer control? Does the concept of control under the Merger Regulation distinguish from the word control used in other fields?

1.1 Method

In these thesis I have been studying literature, publications from the European Commission and several cases from the Commission and the Court of first Instance.

1.2 Outlines

The Coal and Steel Community has not been taken into account in this thesis. When studying the concept of control I have been concentrating on Minority shareholding, Veto Rights and Starting up periods.

2. THE MERGER REGULATION

The main competition rules of the EC-law are set out in Articles 85 and 86 under the EC-Treaty. Article 85 deals with agreements, decisions and concerted practises that restrict or distort the competition within the European Community. Article 86 prohibits abuse of a dominant position. Council Regulation 4064/89 on the control of concentrations between undertakings, also called the Merger Regulation, is an extension of articles 85 and 86. The Merger Regulation became effective

¹ Competition Policy newsletter , Number 2 june 1999

² European Community Competition policy, XXVIIIth Report 1998

on September 21 1990 and is the first EC statute regulating mergers and acquisitions outside the coal and steel sector.

The Merger Regulation applies to operations where a concentration is created, within the meaning of Article 3 of the Regulation. A concentration must meet certain turnover thresholds set out in Article 1 in order to fall under the Merger Regulation. If a transaction is deemed to be a concentration you have to find out whether the concentration is compatible with the common market or not. When a concentration creates or strengthens a dominant position, as a result of which effective competition would be significantly impeded, in the community or a substantial part of it, the concentration violates the Merger Regulation.

2.1 Notification

Under the Merger Regulation undertakings are obliged to give the Commission prior notifications of concentrations with lasting bases and community dimension³. A concentration has a community dimension when the combined aggregate world-wide turnover of the undertakings concerned is more than ECU 2500 millions or the combined aggregate turnover in each of at least three Member States is more than ECU 100 million.⁴ These thresholds were set out because mergers with significant crossborder effects should be dealt with on community level and benefit from a “onestopshop” procedure for the reason of efficiency and legal security. The Merger Regulation does not require that an undertaking must be established in or have its production within the community in order to fall under the regulation. The important issue is if a concentration will or will not distort competition in the common market. This was made clear by the Court of First Instance in its judgement in *Gencor/Lonrho*⁵ in 1999.

The notification of the concentration to the Commission must be done within one week from the event giving rise to the concentration i.e. the conclusion of the agreement, the announcement of the public bid or the acquisition of a controlling interest.⁶ A concentration is not allowed to be put into effect before it has been notified to the Commission and been

³ Council Regulation 4064/89 Article 4

⁴ Council Regulation 4064/89 Article 1:3

⁵ Court of First Instance 25.3.99, Case T-102/96

⁶ Council Regulation 4064/89 Article 4

declared compatible with the Community market.⁷ There is however a possibility for the suspension period to be lifted under certain circumstances⁸. If there are doubts about whether a concentration creates or strengthens a dominant position that would distort the competition within the Community, the Commission opens a detailed *second phase investigation* of the concentration⁹

3. CONCENTRATION

The definition of a concentration in the Merger Regulation is based on a “change in control” principle. If a transaction does not involve a change in control there will be no concentration within the meaning of the Merger Regulation. The definition of a concentration according to article 3(1) of the Merger Regulation is;

“Two or more previously independent undertakings merge, or one or more persons already controlling at least one undertaking, or one or more undertakings acquire whether by purchase of securities or assets, by contract or by any other means, direct or indirect control of the whole or parts of one or more other undertakings.”

Thus there are two ways for a concentration to be established, by a merger between former independent undertakings or from an acquisition of control.

When deciding whether or not a transaction constitutes a concentration that falls under the Merger Regulation, the Commission focuses on the concept of control and looks rather on qualitative criteria than quantitative ones. In order for a concentration to occur the transaction must give rise to a lasting change in control of the undertaking.

Since there is a big difference between having the decisive influence singly or jointly with other persons or undertakings, an operation where someone who used to have sole control gets joint control, by for example taking a partner, constitutes a concentration. The same goes for joint control if someone decides to buy a partner out and hereby gets sole control. In

⁷ Council Regulation 4064/89 Article 7

⁸ See Commission Decision of 15.1.1999, Case No 1419

⁹ In 1998 12 decisions to open phase II proceedings under article 6(1)c of the Merger Regulation were taken.

Avesta II ¹⁰ the shareholders were having joint control. A reduction of the shareholders, the remaining still having joint control, led to the creation of a concentration. In this case one shareholder acquired full veto rights, which according to the Commission led to a change in the quality of control.

If one part of a concentration is acquired with sole control and another part with joint control, there are in fact two different concentrations. It is noteworthy that the Commission in cases with more than one concentration may issue more than one decision.

When an operation consists of undertakings owned by the State or a public body being as well acquired as the acquiring one the operation is considered to be a concentration only if the undertakings formerly were parts of different economic units and were having an independent power of decision. This was shown in NESTE/IVO¹¹. The Finnish State established a holding company, IVO-Neste, owned 100 % by the Finnish State, to implement a merger between two state owned companies, Neste and IVO. Both companies constituted an economic unit with power of decision. The first step was to transfer the shares in Neste to the holding company. This was considered to be an internal restructuring within the state. The second step was to transfer the shares of IVO to IVO-Neste. This step was considered to constitute a concentration within the meaning of the Merger Regulation. Internal restructurings cannot constitute a concentration since there is no change in control.

In Ford/Hertz¹², Ford Motor Company was offered to purchase Commerzbank's 5 % shares of Hertz corporation. By this agreement Ford would hold 54 % of Hertz. Before the agreement Ford was already the single major shareholder of Hertz with 49% of the voting shares. Ford had the power to appoint 4 of a total of 9 directors of the Board and had also the power to convert shares that would give them power to increase their power to appoint directors of the Board to an absolute majority. Although Ford did not have the control "de jure" of Hertz it had "de facto" sole control. This operation, Ford buying 5% of Hertz and thereby getting "de jure" control of Hertz, did not change its decisive influence and did not thereby constitute a concentration.

¹⁰ Commission Decision of 9 June 1994, Case No IV/M.452

¹¹ Commission Decision of 2 June 1998, Case No IV/M.931

¹² Commission Decision of 7.3.1994, Case No IV/M.397

In Eridania/ISI¹³ Eridania acquired 15 per cent of the shares in ISI from Finbieticola and increased its shareholding from 50 to 65 per cent. Finbieticola's shareholding was decreased from 50 to 35 per cent. Prior to the operation the undertakings were having joint control, Eridania was handling the day to day care and Finbieticola had the ability to exercise decisive influence on strategic decisions. After the operation Finbieticola, holding 35 per cent of the shares, retained certain veto rights by a shareholders agreement. Since the veto rights of Finbieticola were not sufficient to be considered as having joint control the operation resulted in a change in control and hereby constituted a concentration.

3.1 Mergers and Joint Ventures

A concentration can arise when two or more previously independent undertakings merge into a new one and cease to exist as different legal entities. It is also possible for one undertaking to be absorbed by another. Joint Ventures performing on a lasting basis and which functions as an autonomous economic entity constitutes a concentration within the meaning of article 3 (1) of the Merger Regulation. In order to be a concentration a Joint Venture must be considered as a “full-function” Joint Venture with a lasting base. A fully functional Joint Venture must be an autonomous economic entity and have a management running the undertaking. It must also have access to sufficient financing, staff manufacturing assets and technology. In other words a Joint Venture must operate in a market where it functions as the other undertakings operating in the same market¹⁴. If a Joint Venture only takes over a specific function such as production or distribution from the parent companies it is not a “full-function” Joint Venture. In these cases the Joint Venture is just considered to be a part of the business activities of their parent companies. The importance of a lasting basis was pointed out by the Commission in TKS/ITW Signode/Titan¹⁵. A Joint Venture agreement shall be of indefinite duration. In this case options could possibly be exercised after five years from the start given opportunity to sole control but the Commission held that a period of five years is long enough to bring about a lasting change. Joint Ventures are often strengthened by cross-shareholdings between the undertakings¹⁶.

¹³ Commission Decision of 30.7.1991, Case No IV/M.62

¹⁴ See Commission Decision of 6.5.1998, Case No IV/M.970, 21.12.1998, Case No IV/M.1368

¹⁵ Commissions Decision of 6.5.1998, Case No IV/M.970

¹⁶ See Commission Decision of 11.6.1998, Case No IV/M.1006

3.1.2 Concentrative or co-operative Joint Venture.

On 1 March 1998 amendments of the Merger Regulation came into effect and extended the scope of the Merger Regulation to also including Joint Ventures known as full function co-operative Joint Venture. Before there was a difference between a concentrative and a co-operative Joint Venture. If the Joint Venture had as its object or effect to co-ordinate a competitive behaviour of undertakings remaining independent it did not fall under the Merger Regulation according to article 2(4). Instead the co-operative Joint Venture fell under Articles 85 and 86 of the EC-Treaty and would hereby be examined under regulation 17/62.

When a Joint Venture, that constitutes a concentration according to article 3 of the Merger Regulation, leads to a co-ordination of a competitive behaviour of independent undertakings, the concentration are to be examined under the Merger Regulation and benefit from the “one-stop shop” and fixed timescales but the effects of the co-ordination of the parents’ activities (spillover effects”) are to be examined in accordance to the criteria of article 85 (1) and (3) of the EC- treaty.¹⁷ When the Commission examine the “spillover effects” it is to look especially if the parent companies retain significant activities in upstream or downstream or neighbouring market to the Joint Venture and if the co-ordination give the undertakings possibility to eliminate competition of a substantial part of the market of the Joint Venture¹⁸.

In case Apollinaris/ Schweppes¹⁹ in 1991 the parties notified their agreement to set up a Joint Venture. This operation was not deemed to be a concentration within the meaning of Regulation 4064/89. The parent companies were to transfer parts of their business to the Joint Venture and the Joint Venture was to be jointly controlled by the parents. But since the parents would still continue their business independently in the same product market as the Joint Venture, although that they would partially withdraw from the market, the Commission held that the Joint Venture would have the effect of co-ordinating the competitive behaviour of the undertakings and hereby it did not constitute a concentration.²⁰ Under the Merger Regulation of today the conclusion ought to be different.

¹⁷ Council Regulation 4064/89 Article 2, paragraph 4

¹⁸ Commission Decision of 3.12.1998, Case No IV/M.1327, p 11,18

¹⁹ Commission Decision of 24.6.1991, Case No IV/M.0093

²⁰ See also Commission Decision of 27.4.1992, Case No IV/M.207

3.2 Acquisition of control

An Acquisition of control is not limited to a take over of legal entities but includes also acquisitions of assets. These assets must however constitute a business with a market turnover.²¹ Acquisition of property rights and shareholder agreement are normally the way to acquire control but economic relationships, such as situations of economic dependency, could also be decisive for the establishing of an acquisition of control. A situation may also occur where the formal holder of a controlling interest is not the person or undertaking that in fact has the power. This could be the case when the financing emanate from another person or undertaking or in case of family links. In all these cases it is the person or the undertaking behind the operation that in fact enjoys the power of control.

The question of control was handled in *Blokker/Toys 'R' Us*²². In this case *Blokker*, who was operating a store as a franchisee took over all the assets of *Toys 'R' Us* in the Netherlands. The parties argued that *Blokker* did not obtain any control by the take over and did not gain anymore security than a typical franchise agreement. The Commission settled otherwise. First *Blokker* took over all the assets of *Toys 'R' Us* in the Netherlands to which a turnover could be attributed. Secondly, the operation consisted of an underlying agreement of long lasting nature, which led to a lasting change in the structure of the undertaking. Thirdly, *Blokker* had the day to day control over the shop and had also the power to decide upon the concept of the shop. Finally *Toys 'R' Us* had stated its intention to leave the Dutch market and the fact that the store was operated as a franchisee did not militate the fact that *Blokker* exercised control over the store. All these facts speak for that *Blokker* had control over the store.

The only occasion the Commission considers the purpose of an acquisition is when a Member State acts as a public authority and not as a shareholder is In these cases the Member State does not have the purpose to exercise decisive influence but public interest and thus in these cases the transactions do not confer control²³.

²¹ Commission Decision of 26.6.1997, Case No IV/M.890

²² Commission Decision of 26.6.1997, Case No IV/M.890

3.3 Exceptions of concentrations

There are three situations, set out in Article 3 (5) of the Merger Regulation, where an acquisition of control does not constitute a concentration. The first is credit and financial institutions and insurance companies who are dealing, for their own account or for others, in securities. In these cases the securities are to be acquired on a temporary basis with an intention to resale them within one year. The acquiring company is not allowed to exercise the voting rights with a view to determining the strategic commercial behaviour of an undertaking. The company must also exercise their voting rights with a view to preparing the disposal of the controlling interest. Secondly, when control is acquired by an officer-holder according to i.e. liquidation, winding up or insolvency law of a Member State no concentration is constituted.

Finally, a financial holding company within the meaning of the Fourth Council Directive 78/660/EEC acquires control of an undertaking does not constitute a concentration provided that they, when exercising their voting rights, do not determine the strategic commercial behaviour of the undertaking concerned and only exercise their rights with a view to maintain full value of its investment.

The question may arise if a rescue operation falls under the exception outlined in Article 3 (5) of the Merger Regulation. In a rescue operation the normal way is for a syndicate of banks to take over the debts of a company through a new established company. If these transactions meet the criteria of joint control a concentration is constituted. An operation like this often requires that the syndicate of banks determine the strategic commercial behaviour of the undertaking and the restructuring of an undertaking normally due over more than one year. Thus, although the banks have the intention to restructure the finance and to resell the company it normally constitutes a concentration and does not fall under the exceptions set out in Article 5.

²³ Cook, Kerse, EC Merger control

4. CONTROL

Article 3 paragraph 3 of the Merger Regulation says “*control shall be constituted by rights, contracts or any other means which either separately or in combination and having regard to the considerations of fact or law involved, confer the possibility of exercising decisive influence on an undertaking, in particular by:*

(a) ownership or the right to use all or part of the assets of an undertaking;

(b) rights or contracts which confer decisive influence on the composition, voting or decisions of the organs of an undertaking.

The “**possibility of exercising**” means that an acquisition of control might occur both with and without intention and it is enough having the possibility of exercising decisive influence to constitute control. (fall Radbank etc.) In Avesta II²⁴ it was settled that control could be acquired inadvertently as a result of the action of a third party. The essential question is whether the rights acquired are sufficient to confer control in the sense of “possibility of exercising decisive influence”.

By “**decisive influence**” in the Merger Regulation the intended meaning of control is distinguished from lesser degrees of influence. You cannot get control without having the power to make the decisions in strategic commercial policy. Thus when deciding on control under the Merger Regulation, the Commission is only interested in the possibility of control over the business strategy of an undertaking, as opposed to rights protecting a minority shareholder’s financial interest. Rights that have been identified as merely protecting a financial interest are for example: veto or approval rights over incorporation decisions, amendments of the undertakings statute and capital increases and decreases. The concept of control under the Merger Regulation only concerns influence normally enjoyed by an owner of an undertaking. Situations where the legislation in a Member State provides special structures of bodies representing the organisation for decision making within an undertaking, such as the rights for employees to be represented in the organisation of the decision making, do not constitute control under the Merger Regulation.

²⁴ Commission Decision of 9.6.1994, Case No IV/M.452

4.1 The nature of control

Control can be positive or negative, direct or indirect.

Positive control rights are e.g. right to appoint management and the right to define the commercial policy of the undertaking. Negative control rights are e.g. the possibility to block decisions with veto rights. The meaning of direct control requires little comment but indirect control may need an explanation. Indirect control may appear in several different situations. An undertaking acquiring control could itself be controlled by another undertaking, which is hereby the one acquiring indirect control. An example is A acquires a controlling interest in B which has a controlling interest in C and D. A will have direct control of B and indirect control of C and D. By acquiring Bessoll, Medeol got control over Elosua because an undertaking owned by Bessoll had 20 per cent of the shares in Elosua. Together with the 37 per cent that Medeol already held it indirectly got sole control over Elosua²⁵.

It is also possible to establish an undertaking to hold shares, with voting rights, in order to express a common interest or exercise unanimously the votes of the owners. Another important quality of control was pointed out in GE/ENI/Nuovo Pignone (II)²⁶ where the Commission held that in order to constitute control a right must be considered to be permanent and not just temporary.

In *Air France/Commission*²⁷ the Court of First Instance held that it is only relevant to look at the legal and factual situation at the time of the notification when deciding about the nature of control. You cannot consider hypothetical factors such as an option of purchasing shares unless it can be assessed at the time for the decision. In *Ford/ Hertz*²⁸ the Commission considered that Ford held shares that could be converted at any time, in a matter of hours and without any further payment, and which would give Ford the possibility to increase their number of directors of the Board and hereby get de jure control of it. However in this case under the circumstances there would be no change in “quality and degree of decisive influence” exercised by Ford.

²⁵ Commission Decision of 6.6.1994, Case No IV/M.431

²⁶ Commission Decision of 6.5.1994, Case No IV/M.440

²⁷ Court of First Instance 19.5.1994, Case No T-2/93

²⁸ Commissions Decision 7.3.1994, Case No IV/M.397

4.2 Sole or joint control

Control can be acquired by one undertaking or one person acting alone, or by two or more undertakings or persons acting together. Thus an acquisition of control can be either sole control or joint control. The difference between sole and joint decisive influence lays in whether you have to take into account the other parties interests or if you just have to consider your own interests. The Commission has emphasised the distinction between joint and sole control in ICI/Tioxide²⁹. ICI, holding 50 per cent of Tioxide, acquired the remaining 50 per cent of the shares from Cookson. From exercising joint control together with Cookson ICI after the transaction exercised sole control. The Commission held that “decisive influence exercised solely is substantially different to decisive influence exercised jointly, since the latter had to take into account the potentially different interests of the other party”. The decisive influence of ICI would change quality and the transaction would bring about a lasting structure and hereby constitute a concentration.

4.2.1 Sole control

Sole control can be conferred on a legal or de facto basis. Sole control confers power upon one specific person or undertaking.

The classic way to acquire sole control is on a legal basis, acquiring an absolute majority of the voting stocks of a company. Acquiring 100 per cent of the voting stocks is the only distinct case when an acquisition of a certain stock percentage constitutes an acquisition of sole control. If a person or an undertaking holds the majority of the voting rights in a company it does not matter if it holds 51 or 100 per cent unless there are other elements of fact or law. Normally an acquisition of the majority of the share capital, which does not include a majority of the voting rights, can not confer control unless there are other elements involved.

Sara Lee/BP Food Division³⁰ is a distinct example where Sara Lee Corporation acquired the entire share capital of BP and hereby acquired sole control of part of a division of BP.

Another way to acquire sole control is with a “qualified minority” on a legal or de facto basis. (See Minority shareholdings)

²⁹ Commission Decision of 28 .11.1990, Case No IV/M.023

³⁰ Commission Decision of 8.2.1993, Case No IV/M.299

4.2.2 Joint control

An acquisition of joint control can be established on a legal or de facto basis.

When two or more undertakings or persons have the possibility to exercise decisive influence over another undertaking they have got joint control. A condition for exercising joint control is the possibility of exercising influence in the strategic decisions of the undertaking. Exercising joint control does not, however, require you to have influence on the day to day running of an undertaking.

The typical situation of joint control occurs when two undertakings or persons share the voting rights equally. An example of a clear case of joint control is Inchcape plc/Gestetner³¹. The parties created a Joint Venture, owned 50/50 by the parties. Strategic decisions required unanimous approval and each party had equal numbers of representation of the board. The post of chairman of the board would rotate annually between the parties.³² In cases of joint control usually the holding percent of the voting shares is not a determining factor for establishing joint control. In TPM/Wood group³³ the parties were holding 51% respectively 49% of the voting shares. Looking only at the votingshares the part holding 51% could be the one having sole control but since most strategic decisions were to be taken unanimously the parties instead had joint control.³⁴

In cases of joint control an understanding in strategic decisions between the parties is necessary otherwise there will be a deadlock situation. The possibility of a deadlock situation is characteristic of joint control. When deciding upon joint control the Commission considers a mutual veto right over strategic decisions to be an essential element of joint control.³⁵ Joint control may also exist when there is no equality in votes or representation in decision making bodies between the parties.

The Commission has expressed that there is a higher probability for parent companies to act jointly on de facto basis in new established Joint Ventures as opposed to acquisition of minority shareholdings. When the parent companies contribute with e.g. technology, know how or supply agreement, it is likely they will act jointly in achieving a common policy. However the likelihood for conduct like this decreases with a larger number of parent

³¹ Commission Decision of 1.6.1995, Case No IV/M.583

³² See also Commission Decisions of 15.1.1998, Case No IV/M.1005 and 18.8.1998, Case No IV/M.1135

³³ Commission decision of 20.7.1998, Case No IV/M.1224

³⁴ See also Commission Decision of 31.3.1993, Case No IV/M.331 and 14.7.1992, Case No IV/M.229

companies. When one party has a casting vote joint control does not exist unless the casting vote only can be exercised after attempts of reconciliation.³⁶

5. MINORITY SHAREHOLDING

5.1 Sole control

Smaller holdings than 50 per cent of the shares may give decisive influence and confer sole control. A minority shareholder can exercise sole control in two situations. If specific rights are attached to the minority shareholding it can confer control. This might be the case with preferential shares or other rights that give the minority shareholder the right to decide the strategic commercial policy of the company.

The second way is if the shares of a company are widely dispersed and it is unlikely that the smaller shareholders will be represented at the shareholders meeting and this could give a minority shareholder majority at the shareholders meeting. When the Commission decides upon sole control in these cases they look at the presence of shareholders on the shareholders meeting in previous years, and in order to achieve sole control the minority shareholder must have a stable majority of the votes. This was the case if VEBA/Degussa³⁷. VEBA acquired all the shares in GFC, which owned 36,41 per cent of Degussa. In deciding whether this level created control or not, the Commission looked upon the five latest shareholders meetings. The attending shareholders had been below 68 per cent and the 36,41 per cent of the shares had assured a majority at the meetings. The next largest shareholder held 6,8 per cent and the other shares were widely dispersed. There was no other individual shareholder that could exercise decisive influence and there had not been any effort in the past to exercise decisive influence jointly. GFC had been exercising control over Degussa and by taking over GFC, VEBA would acquire the controlling interest. In this case the Commission also noticed VEBA's knowledge of the market and the industries and pointed out that the next largest shareholder had no knowledge of the kind. This remark is interesting. Reading the case you

³⁵ Commission Decision of 14.3.1995, Case No IV/M.548

³⁶ Commission Decisions of 28.3.1994, Case No IV/M.425, 4.8.1998, Case No IV/M.1097 p.11

get the impression that the knowledge of the market point towards a higher presuming of sole control exists. In its “Notice on the concept of concentration”³⁸ the Commission states that the fact that one of the parent companies enjoys specific knowledge of the business of a Joint Venture do not militate the possibility for joint control.

Holdings between 35 and 50 per cent of the voting shares have often been found to create sole control on de facto basis. This issue was brought up for the first time in Arjomari/Wiggins Teape Appleton³⁹. In this case the 39 per cent shareholding of Arjomari in the undertaking WTA were sufficient to give Arjomari the ability to exercise decisive influence and thereby de facto sole control. The shares were widely dispersed among 107 000 shareholders and there was no other shareholder with more than four per cent of the shares. Looking at the former shareholder meetings there was no voting pattern that might be a threat to Arjomaris 39 per cent.

In Société Générale de Belgique/Générale de Banque⁴⁰ a small level was settled to create decisive influence. The shares were widely dispersed between small investors and the public and the shareholders meetings were not well attended. Decisive influence and sole control were achieved at 25,96 per cent of the voting shares.

The opposite happened in Holdercim/Orginy-Desvroues⁴¹. Having the three general meetings in mind a shareholding of 42 per cent was not enough to achieve de facto control.

5.2 Joint control

A minority stock holding can constitute joint control depending on the legal and factual circumstances surrounding it. Shareholdings of 10-25 per cent have been found to constitute joint control. Thomas Cook/LTV/West LB⁴² is an example where a 10% shareholding gave the holder joint control with the owner of 90 per cent of the votingshares because special rights were appointed in a shareholders agreement.

Minority shareholders can act together exercising their voting rights in order to assert a common commercial or finance interest and if they get the majority of the voting rights they

³⁷ Commission Decision of 3.12.1997, Case No IV/M.942

³⁸ OJ C 66 of 02.03.1998

³⁹ Commission Decision of 10.12.1990, Case No IV/M.0025

⁴⁰ Commission Decision of 3.8.93, Case No IV/M.342

⁴¹ Commissions Decision of 5.8.1994, Case No IV/M.486

⁴² Commission Decision of 14.7.1992, Case No IV/M.229

can hereby jointly obtain joint control of an undertaking. A conduct like this can be based on a legal basis, e.g. in an agreement so called “pooling agreement” by which they agree to act in the same way or by establishing a holding company that exercises the voting rights of the shareholders. However co-operation between a number of shareholders in different situations on a facto basis is unlikely to hold a stable majority in the decision-making procedure and the changes of combinations in different issues can be very insecure. Thus in these cases it cannot be presumed that the minority shareholders will have joint control. This was made clear by the Commission in NEC/BULL/PBN⁴³. Out of the nine members of the board of PBN, NEC had the power to appoint three, BULL two and the founders of PBN four. NEC and BULL claimed to have joint control over PBN but the Commission held that a concerted voting in the future was a pure assumption and was not sufficient to constitute joint control since there were no other legal or factual elements involved. Another example is when three persons or undertakings hold equal shares in a Joint Venture and can appoint equal numbers of the Board. If the decisions of the Joint Venture are taken with simple majority the shareholders do not have joint control. A common interest exercising the voting rights of minority shareholdings are indicated by prior links between the shareholders and by a joint procedure at the acquisition of the shares.

A minority shareholder may hold a veto right in strategic commercial decisions that can confer joint control. These veto rights could be set out in an agreement or by the statute of the Joint Venture. The nature of such veto right can vary e.g. certain decisions could require approval by a body where the minority shareholder is represented. As mentioned before such veto rights cannot constitute control if they protect a financial interest but must concern strategic decisions. In EDFI/ Graninge⁴⁴ the Commission settled that the owners of a 45,9% of the voting power would acquire joint control based on the number of shareholders represented at the shareholders meeting in the two last years.

⁴³ Commission Decision of 6.2.1998, Case No IV/M.1095

⁴⁴ Commission Decision 25.10.1998, Case No IV/M.1169.

6. STARTING UP PERIODS

When deciding about situations when the control changes shape after the starting up period, the control is considered to have the nature which is to be after the starting up period. Thus if joint control is acquired over an undertaking for a starting up period but will change into sole control after this, the starting up period will be considered as an immediate acquisition of sole control. In order to do so there must exist a legally binding agreement affirming that the joint control will be converted into sole control after the starting up period. In *British Telecom/Banco Santander*⁴⁵ the Commission stated that a starting up period should not exceed three years. The Commission held that since Santander only would be able to exercise decisive influence for the first three years this would not be sufficient to bring about a lasting change in the structure of the Joint Venture. The business plan of the Joint Venture covered a ten-year period and the nature of the investments was of long term.⁴⁶

In *GE/ENI/NUOVO PIGNONE*⁴⁷ General Electric bought 69,33 per cent of Ente Nazionale Idrocarburis (ENI) shareholding in Nuovo Pignone. Out of the nine Members of the Board, General Electric would appoint seven and two would be appointed by ENI. Decisions of the Board of Directors were to, in certain matters, require the approval of at least one of the two directors appointed by ENI. This veto right would expire within three years. In its decision the Commission held that in order to confer control within the meaning of article 3(3) of the members of the Board. In the Development Phase (the first three years) British Telecom and BNL had agreed on an Initial Business Plan covering the first 10 years. However the annual update of the Plan required only simple majority. BNL would hold certain rights in the Merger Regulation ENI must have a permanent possibility to exercise veto rights over a broader range of issues.

In *Albacom*⁴⁸ British Telecom and BNL (an Italian Bank) created Albacom, a new business telecommunication operator in Italy. British Telecom would own 50,5 per cent of the shares and appoint four members of the Board and BNL would own 49,5 per cent and appoint three members of the Board. In the Development Phase (the first three years) British Telecom

⁴⁵ Commission Decision 28.3.1994, Case No IV/M.425

⁴⁶ See also *Albacom*, Commission Decision 15.09.1995, Case No IV/M.604

⁴⁷ Commission Decision of 6.5.1994, Case No IV/M.440

⁴⁸ Commission Decision 15.9.1995, Case No IV/M.604

and BNL had agreed on an Initial Business Plan covering the first ten years. However the annual update of the Business Plan required only simple majority. BNL would hold certain rights in the appointment of the Chief Executive Officer and have joint rights for the review of the Business Plan. The Commission pointed out that the principal rights held by a minority shareholder in order to exercise decisive influence were the appointment of the management and the determination of the budget. Next in importance is the influence on the Business Plan. In Albacom BNL would have joint control over Albacom in the Development Phase according to its rights on the Business Plan and the appointment of the Chief Executive Officer. But after the Development Phase had expired BNL's rights would be limited and they would no longer have decisive influence over Albacom. The Commission's conclusion was that a three-year decisive influence is insufficient to bring about a lasting change and British Telecom were deemed to have sole control over Albacom.

7. VETO RIGHTS

The content of the veto rights decides whether one veto right is enough to confer joint control or if more than one veto right is required. When looking at the content of the veto right you have to look at it in the context of the specific business of the Joint Venture. A veto right must, in order to create joint control be sufficient to exercise influence on commercial strategic decisions. It is enough having the possibility of exercising influence; you do not have to make use of it. Veto rights concerning issues and decisions on budget, business plan, major investments and appointment of management are related to strategic commercial decisions conferring joint control.⁴⁹ It is not in all cases that a right to object in strategic decisions constitutes an absolute veto right. If somebody in spite of the existence of an agreement of a right to object in strategic decisions, holds a casting vote the right to object does not constitute an absolute veto right.⁵⁰ Veto rights may be set out in the statute of an undertaking or in an agreement between the parties.

⁴⁹ Commission Decision of 6.5.1998, Case No IV/M.970

⁵⁰ Commission Decision of 4.8.1998, Case No IV/M.1097 p10

In cases where someone has a veto right, control can exist even if there is no equality between the undertakings in vote or in representation in the decision making bodies. In *Air France/ Commission*⁵¹ the Commission held that a Joint Venture was jointly controlled between British Airways and TAT although TAT held 50,1 per cent of the shares with voting rights and British Airways 49,9 per cent. The reason was that British Airways held a veto right in major decisions.

Decisions concerning changes in the statute, increase or decrease of the capital or liquidation is regarded as decisions normally protecting rights of minority shareholders and thus not constituting control.

In *Ford /Hertz*⁵² the Commission stated that Fords veto rights on issuance of shares, amendments of the statutes, acquisition or divestitures and vehicle supply agreement did not confer control since they did not include essential matters for exercising decisive influence. In *Appolinaris/Schweppes*⁵³ the condition that Schweppes was to increase its shareholding from 28 per cent up to 50 per cent within the five years of the Joint Venture was considered to be a plus factor in determining joint control.

Situations may occur where one shareholder is able to veto in strategic decisions. This is the case when one shareholder holds 50 % of the shares and the remaining shares are held by two or more persons or undertakings. Since the shareholder cannot impose a decision on his own he cannot be considered having sole control. The single shareholder has in these circumstances the same power as a shareholder having joint control in an undertaking – the possibility to block a decision and therefor he has decisive influence and control within the meaning of the Merger Regulation.

7.1 Veto Rights on Appointment of management and decisions on the budget.

Veto on Appointment of management and decisions on the budget are normally the most important veto rights that give you a strong power to exercise decisive influence. If you have

⁵¹ Court of First Instance 19.5.1994, Case T-2/93

⁵² Commissions Decision of 7.3.1994, Case No IV/M.397

⁵³ Commission Decision of 24.6.1991, Case No IV/M.93

51 Commission Decision of 6.5.1998, Case No IV/M.970

the possibility to decide on the budget you get to decide the framework of the activities of the Joint Venture⁵⁴.

7.2 Veto Rights on the business plan

Whether veto rights on the business plan can constitute joint control or not depends on its shaping. If the business plan only contains general declarations on the business aims it is not sufficient in itself to confer joint control. It can, however, together with other elements confer joint control. If the business plan on the contrary provides measures to be taken in order to achieve the aims of the Joint Venture such veto right in itself can confer joint control.

7.3 Veto Rights on investments

The investment policy of an undertaking can be an important element when deciding upon joint control. This is the case when investments make an essential feature of the market in which the Joint Venture is active. In these cases a veto right on investment is important when deciding upon joint control. On the other hand there are markets where investments do not have an important role in the market behaviour of an undertaking and consequently is not an important element deciding if joint control exists.

The level of an investment subject to veto could also be important. In these cases an extremely high level of the investment may rather fall under the normal protection of a finance investment than a decisive influence.

7.4 Veto Rights related to special decisions

Naturally, different decisions of a Joint Venture are different in importance depending on in what market the Joint Venture operates, one kind of decision essential in one market can be unessential in another. Decisions on the technology used by the Joint Venture are one example, request for a significant degree of innovation is another. If someone holds a veto right on a decision like mentioned before it could be an important element in the process when the Commission is about to decide whether joint control exists or not.

8. CONCLUSIONS

The concept of control under the Merger Regulation is distinguished from the one used in other fields, i.e. tax legislation. “Control” under the Merger Regulation is the possibility of exercising decisive influence. Decisive influence means having the possibility of making decisions in strategic commercial policy of the undertaking. It is clear that control in this sense means something less than legal control. In determining the concept of “control” the perspective is rather an economic one than a legal one. Exercising your right in order to protect a financial interest as a minority shareholder does not confer control.

When deciding whether control exists or not within the meaning of the Merger Regulation the Commission focuses on the substance of the transaction and on the effects of the transaction. The most typical means of obtaining control are acquisitions of securities and assets. In practice it is rare that anyone obtains control without an acquisition of securities or assets.

In some cases the existence of control is shown immediately and in other cases it takes a full economic analysis of a transaction in order to establish whether control exists or not. The factual situation surrounding the transaction is determining for settling who in fact is in control. This is often the case regarding minority shareholding in another undertaking. The percentage of shares does not in most cases show who has the control. Sole and joint control are often conferred from specific rights attached to the shares. Sole control often arises when the shares of a company are widely dispersed and joint control can occur from a “pooling agreement” – exercising the votes together.

Regarding starting up periods it is clear that the nature of control is decided by which form the control is supposed to have after the end of the starting up period. In cases of starting up periods the situation of a lasting change is determining for the control.

Regarding Veto rights the appointment of the management and decisions on the budget are the most important ones deciding upon control. Veto rights on the businessplan and on investments are also important. If you are in the position of having more than one of these veto rights the situation of control is more obvious.

Judging from the cases I have been studying, my opinion is that the Commission has a distinct view on which transactions confer control and the nature of the control. This is also shown in the low number of cases which are appealed in a higher court.

In the Recite 12 of the Merger Regulation is stated a non discrimination principle between State and undertakings. However, when deciding the meaning of “control”, the Commission handles States differently from undertakings. When a Member State is the acquiring one it considers the purpose of the acquisition. This conduct could be looked upon as politically convenient.

9. TABLE OF CASES

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Case T-102/96, 25.3.1999	Gencor/Lonrho

The Commission

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