Defining "Merger" Transactions for Purposes of Merger Review

I. Introduction

The ICN's Recommended Practices for Merger Notification and Review Procedures ("RPs") provide considerable guidance on jurisdictional nexus and notification thresholds for purposes of defining transactions that are properly subject to merger notification and review requirements. As a matter of first principles, a merger review regime must also define the type of transactions that potentially qualify for notification as "mergers."[1] Although the definition of qualifying "merger" transactions is not expressly dealt with in the RPs, it is a critical issue from an enforcement policy perspective and it is fundamental to the transparency of the merger review process as set out in RP VIII (B) comment 1. While the precise technical terms may differ according to applicable local laws, the overriding aims of the definition of "covered transactions" are to capture those transactions that merit notification and review as "mergers" under applicable substantive merger legislation, while at the same time providing clear and easily understandable standards that enable merging parties to readily ascertain their notification obligations.

II. General Principles

As a general matter, merger review statutes and regulations are directed at business transactions in which two or more previously independent economic undertakings are combined in some fashion that involves a lasting change in the structure or ownership of one or more of the undertakings concerned.[2] The types of qualifying business transactions typically include some form of merger between two or more previously independent undertakings, by the acquisition of control or some degree of influence by one undertaking over the whole or part of another undertaking, or by some combination of all or part of the business operations of two or more undertakings to create a new business enterprise (e.g., consolidations, amalgamations and joint ventures).

The degree of economic integration between the parties and the duration of the relationship (both subsumed in the notion of a "lasting structural change" under the EC Merger Regulation) are often utilized to distinguish qualifying "merger" transactions from mere collaborative arrangements, which are normally reviewd under competition

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[1] As used herein, the term "merger" is intended to refer to various types of acquisitions and business combinations comprising "covered transactions" for merger control purposes, as opposed to a specific transactional structure under applicable business laws.

[2] Because potential competitive concerns are normally limited to some form of combination between previously independent economic actors, restructurings and reorganizations that occur within the same group (i.e., a restructuring of two wholly-owned subsidiaries by their common parent or between two divisions of the same company) are typically not subject to merger review.

laws that are primarily directed at anticompetitive agreements between independent undertakings, such as Section 1 of the Sherman Act in the United States and Article 81 of the EC Treaty. Qualifying business transactions are termed "concentrations" under the ECMR and the German Act Against Restraints of Competition ("ARC"). In the United Kingdom, such transactions are referred to as a "relevant merger situation" in which two or more enterprises "cease to be distinct" under the Enterprise Act 2002.

Almost universally, merger review regimes cover outright acquisitions of one firm by another, whether the transaction is structured as an acquisition of 100% of the seller's shares or 100% of the seller's assets. Likewise, merger review regimes almost universally cover acquisitions of shares or assets falling short of the 100% threshold where the transaction nevertheless results in an acquisition of "control" of a business enterprise. Qualifying transactions may include both acquisitions of "sole control" by one firm over another, and acquisitions of "joint control" of a firm by two or more firms.[3] Many jurisdictions also cover acquisitions of shares that, while falling short of a controlling interest, nevertheless give rise to the potential ability of the acquiring firm to exert some degree of influence over the acquired company.

Set out below is a general discussion of how various jurisdictions address these issues in defining those types of business transactions that may be subject to merger review. Although specific terminology may vary by reference to the business laws of the jurisdictions concerned, the discussion is divided into three sections, which correspond to the main categories of covered transactions: share acquisitions, asset acquisitions, and joint ventures. Representative exemplars of statutory and regulatory approaches to these issues in various jurisdictions are attached as annexes for further reference.

III. Types of Qualifying "Merger" Transactions

A. Share Acquisitions

Acquisitions of shares (or other equity interests such as partnership interests or LLC interests) typically qualify as "mergers" for merger review purposes whenever they result in an acquisition of "control" of the target. Thus, for example, a qualifying transaction arises whenever the buyer obtains a controlling equity interest in the target such that it can exercise "decisive influence" over the target's business operations. An acquisition of "control" presumptively arises whenever the purchaser acquires a majority of the target company's shares, such that the purchaser obtains voting rights that permit it to control the target company's board, management and/or business direction. In the EU, the requisite change in "control" may also be brought about by acquisitions of shareholdings falling short of an outright majority stake, where such holdings would nonetheless enable the acquirer -- alone or together with other shareholders -- to block the

[3] "Joint control" may be achieved, for example, where a transaction results in a 50/50 equity split, such that mutual agreement is necessary for management decisions and/or where one party is capable of exercising veto rights over proposed actions. Transactions that involve shifts from "joint control" to "sole control" (or vice versa) may also give rise to a qualifying change in "control."

adoption of strategic decisions, for example, through the exercise of veto rights, or other arrangements which permit the acquirer to exercise *de facto* decisive influence over the target.

Many merger review regimes also cover share acquisitions that fall short of an outright majority of the target company's shares where the purchaser may nevertheless have the potential ability to exert significant influence over a company. In many jurisdictions, the relevant legislation sets out specified percentage levels that trigger a notification requirement. In Japan, for example, separate notifications are required for share acquisitions in excess of 10%, 25% and 50% shareholding levels. Under Canadian rules, notification is required for acquisitions of more than 20% of the shares of public companies and more than 35% of the shares of non-public companies.

Rather than using a test based solely on shareholding percentages, other jurisdictions examine additional factors in assessing whether minority interests may give rise to the requisite "ability to influence." In Germany, for example, the ARC not only requires notification of any acquisition of 25% or more of the capital or voting rights of another undertaking, but also acquisitions that fall below the specified 25% threshold to the extent that the transaction would enable the buyer to exercise "a competitively significant influence" over the target company. Similarly, the United Kingdom's OFT guidelines state that acquisitions of minority shareholdings of between 10% and 15% may be subject to merger review to the extent that such shareholdings may give rise to the ability to exercise "material" influence over the target company. The factors the OFT will take into account in making this determination include whether the minority shareholder is accorded special voting rights or veto rights, board representation and/or financial interdependence. The acquisition of minority interests are likewise subject to notification requirements in South Africa if a shareholder agreement (or other similar agreements) gives the buyer the ability to "materially influence" the policy of the target company.

The United States generally requires premerger notification of any share acquisition that is valued in excess of $59.8 million (annually adjusted for inflation), irrespective of the resulting percentage shareholding. Acquisitions of minority stakes of 10% or less (15% or less by certain institutional investors such as banks and investment companies) are exempt under the Hart-Scott-Rodino Act ("H-S-R") notification requirements if made "solely for purposes of investment" (i.e., passive investments where the purchaser has no intention to seek to influence the business affairs of the target company). Share acquisitions by securities underwriters "in the ordinary course" of their business are also exempt from H-S-R notification requirements irrespective of the value of the transaction.

Other jurisdictions also set out special rules for "ordinary course" share acquisitions by financial institutions. In the EU, acquisitions of securities by a credit or financial institution with a view to resale within one year in the ordinary course of business benefit from an exemption from the notification requirements, as do any transfers in control of companies to liquidators in connection with insolvency proceedings. South Africa also provides exemptions for certain types of share acquisitions by financial institutions in the context of "ordinary course" financing arrangements.

B. Asset Acquisitions

Transactions in which the purchaser acquires all or substantially all of the seller's business assets are almost universally viewed as qualifying transactions for merger review purposes. Many jurisdictions also cover asset purchases even though they may not constitute all or substantially all of the seller's assets. Here, there is no question that there has been a change in control of the assets. Rather, the pertinent question is whether the acquired assets have sufficient economic significance to merit merger review coverage. Under the ECMR, for example, an acquisition of assets will only be considered a "concentration" if those assets constitute the whole or a part of an entity to which a market turnover can be attributed. Japan requires notification of asset acquisitions only if the turnover attributable to the acquired assets exceeds 1 billion yen.

It is typically not necessary, however, that the acquired assets represent an actual going concern or otherwise comprise a stand-alone business enterprise. The German ARC, for example, covers acquisitions of "a substantial part of the assets of another undertaking," and transactions may qualify as concentrations notwithstanding the fact that the acquired assets do not constitute a "substantial part" of the seller's assets in a quantitative sense. Rather, asset acquisitions may qualify as concentrations under the ARC whenever the assets have independent competitive significance in connection with production or distribution in some relevant market. Thus, for example, qualifying transactions can include the acquisition of a single business establishment (e.g., a single food chain outlet), an unincorporated business unit (e.g., a manufacturing division), or intellectual property rights. The ECMR likewise covers acquisitions of intangible assets (*e.g.*, intellectual property rights) if those assets are the basis for an existing economic activity to which a market turnover can be attributed.

In the UK, a "relevant merger situation" arises whenever "two or more enterprises cease to be distinct." The term "enterprise" is defined as the activities, or part of the activities, of a "business." A qualifying "enterprise" does not need to be a separate legal entity; a qualifying transaction may arise whenever it involves the transfer of assets sufficient to carry on a business. Thus, while the acquisition of a business by another business as a going concern will inevitably give rise to a qualifying transaction, enterprises may also "cease to be distinct" if only part of the seller's business is acquired so long as the acquired assets include those components that are needed to carry on a business. However, an acquisition of assets does not in itself amount to "enterprises ceasing to be distinct" unless this minimal "business activity" test is met.

In the United States, the H-S-R Act and rules generally cover asset transactions whenever the acquired assets are valued in excess of $50 million (as adjusted) but then exempt from notification various categories of asset acquisitions that are likely to lack competitive significance. Importantly, acquisitions of assets "in the ordinary course of business" are exempted, and this exempts most acquisitions of new goods, current supplies and used durable goods. Acquisitions of "all or substantially all of the assets of an operating unit," however, are excluded from the definition of "ordinary course" transactions and are therefore subject to the H-S-R Act if the $50 million (as adjusted) threshold is met. Similarly, acquisitions of certain real property assets, such as undeveloped land, and office or residential property are also exempted under the H-S-R rules, as the agencies view such transactions as unlikely to raise competitive issues. In Canada, certain acquisitions of financial assets undertaken in the context of ordinary course financing arrangements (i.e., asset securitization transactions) are also exempt from notification.

C. Joint Ventures

Most merger review regimes also include the formation of joint ventures as qualifying merger transactions. Given the rather flexible notion of what constitutes a "joint venture", it is difficult to generalize in this area. As a general proposition, however, joint ventures involve some pooling of resources to create a new business enterprise on a more or less permanent basis. The distinguishing features of qualifying joint ventures – as opposed to mere collaborative arrangements – include economic integration of the parties' business activities (as, for example, through a contribution of productive assets to a new business undertaking), the elimination of competition between the parties in the joint venture's field of activity through this contribution, and the relative permanence of the joint business activity.[4]

Where these basic criteria are met, joint venture transactions are often brought within the general scope of applicable merger review laws by reference to the fact that the creation of a qualifying joint venture will typically involve the transfer of voting securities or assets, by reference to the underlying combination of previously independent businesses and/or through specific definitional coverage in the jurisdiction concerned.

Under the U.S. H-S-R rules, for example, joint ventures are captured to the extent that one or more of the parties to the venture is deemed to be acquiring assets or voting securities that meet the general $50 million valuation test. The formation of a joint venture is likewise subject to merger notification requirements in Japan if it results in an acquisition of the new company's shares or the transfer of the parent companies' assets to the new company that meet the thresholds generally applicable to acquisitions of shares and assets, respectively.

In the UK, the formation of a joint venture may fall within the purview of the Enterprise Act 2002 whenever the operation gives rise to a situation in which two or

[4] The collaborative features of joint venture arrangements may also be subject to review in the jurisdiction concerned under competition laws that are primarily directed at anticompetitive agreements, such as Section 1 of the Act Against Restraints of Competition in Germany.

more enterprises "cease to be distinct." In the EU, joint ventures are covered under the ECMR under the general definition of a "concentration," which includes transactions in which two or more undertakings participate in the creation of an autonomous economic entity – otherwise known as a "full function joint venture". The joint venture must represent more than a mere collaboration between companies. Rather, to qualify as a "concentration," the joint venture must constitute an autonomous economic entity that can operate on the market independently of its parent companies on a lasting basis.

IV. Concluding Observations

The themes advanced in the ICN's Guiding Principles and Recommended Practices for Merger Notification and Review Procedures include the development of notification procedures that promote effective enforcement of substantive merger review laws, efficient allocation of enforcement agency resources, clear guidance to merging parties vis-à-vis their reporting obligations, and the avoidance of unnecessary transaction costs associated with the merger notification process.[5] Achieving all of these objectives often requires a balancing of these sometimes competing interests. These same objectives – and potential tensions – are also relevant to the exercise of defining qualifying "merger" transactions for purposes of merger review laws.

Many jurisdictions have put in place a dedicated legislative framework specifically for merger notification and review, distinct from the framework for assessing the competitive impact of business conduct more generally, so as to ensure that changes of ownership which may have an impact on market structures can be scrutinized in a timely and speedy fashion. Such a specific legal framework, whether mandatory or voluntary, facilitates law enforcement and can increase legal certainty to investors. However, if the category of transactions that potentially qualify for notification as "mergers" is defined too broadly, the result may be to capture many types of ownership changes that are unlikely to have a material impact on competition, thus placing a greater burden on business and law enforcement resources than would seem justified. Conversely, a definition of "mergers" that is too narrow may mean that, in some jurisdictions, transactions raising potential competition concerns may not be challenged or can not be examined under a jurisdiction's merger review laws.[64] Jurisdictions must weigh these considerations in defining qualifying "merger" transactions for the purposes of their merger notification and review laws.

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[5] **Error! Main Document Only.**The Guiding Principles and Recommended Practices for Merger Notification and Review Procedures are available at:
http://www.internationalcompetitionnetwork.org/index.php/en/publication/294.
In particular, Recommended Practices I (nexus), II (thresholds), and VIII (transparency) may prove of assistance in defining merger transactions for purposes of merger review.

[6] Recommended Practice IV on Review Periods recognizes the importance of completing merger reviews in a reasonable and determinable period of time. By contrast, antitrust reviews that are not limited as to the duration of the review may involve protracted legal uncertainty for the businesses concerned.

Clearly, transactions whereby one business enterprise acquires control of another or whereby two previously independent enterprises otherwise combine their operations merit coverage as qualifying mergers, consistent with generally prevailing international practice. At the same time, a definition which is limited to a “change in control” via the acquisition of a majority of a company's shares may be considered under-inclusive in the context of share acquisitions since it fails to capture minority acquisitions that, while falling short of control, nevertheless give the acquiring firm the ability to influence the management and operations of the target and thereby affect its competitive conduct.

With respect to acquisitions of assets, the main definitional issue – in contrast to share acquisitions – relates not to “control” or “ability to influence”, but to whether the acquired assets have sufficient competitive significance so as to give rise to an appreciable economic concentration in the marketplace. This notion is often captured by reference to whether the assets comprise an “enterprise” or business activity to which turnover may be attributed. Here again, however, it should be borne in mind that a definition limited to acquisitions of an ongoing business enterprise – while relatively clear-cut – may fail to capture a wide range of transactions of potential competitive significance, i.e., transfers of intellectual property rights such as patents and trademarks.

In all events, the definition of qualifying “merger” transactions should provide clear and easily understandable standards that will enable merging parties to readily ascertain their notification obligations. With respect to share acquisitions, objective tests predicated upon specified shareholding percentages (e.g., 50%, 25%, 15%) have the advantage of providing clear and unambiguous guidance to merging parties. On the other hand, as many jurisdictions have recognized, absolute percentages may understate the extent to which the shareholder may influence the target’s business as, for example, through special voting rights, shareholder agreements or veto rights which may give the acquiring person effective control of the target notwithstanding the fact that it may hold less than 50% of the target’s shares. Likewise, as previously discussed, definitions of qualifying asset acquisitions that are confined to assets which comprise the entirety of an ongoing business enterprise, while more readily identifiable, may be considered unduly narrow.

Whether applied to acquisitions of shares or assets, more subjective tests, while perhaps appropriate from the standpoint of effective enforcement, need to be articulated in a clear and easily understandable manner that gives merging parties adequate guidance as to their notification obligations. Efforts to provide such guidance include, for example, the European Commission’s “Notice,” the UK Office of Fair Trading’s “Mergers-Procedural guidance” publication, and the Bundeskartellamt’s “Information leaflet on the German control of concentrations.”

Finally, in considering these definitional issues, it is important to distinguish between the definition of “covered transactions” for purposes of merger notification requirements, on the one hand, and jurisdiction over transactions for purposes of substantive merger review, on the other. In many jurisdictions, such as the EU, most EU

Member States and many other countries, these definitions are co-terminous. In other words, if a transaction does not qualify as a "concentration" for purposes of the merger notification and waiting period requirements, the enforcement agency lacks jurisdiction over the transaction altogether – at least under its merger review laws. In contrast, other jurisdictions, including the United States, Canada, Japan and Mexico, retain jurisdiction over - and, correspondingly, the ability to challenge - transactions that are not subject to pre-merger notification and waiting period requirements.

The preceding discussion is focused on how transactions are defined for purposes of merger notification coverage, without regard to whether the enforcement agency may have broader authority to review and challenge non-reportable transactions. It is recognized, however, that the scope of definitional coverage may be affected by substantive jurisdictional considerations.