FOCUSING ON PRIVATE EQUITY: GLOBAL MERGER CONTROL IMPLICATIONS

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I. INTRODUCTION

Cross-border mergers and acquisitions surged to a 10-year high in 2017, with billion-dollar deals increasing by 14 percent over 2016, necessitating merger control clearances worldwide. Contributing substantially to this uptick, private equity firms took starring roles as principal investors, consortium members or as sources of financing. In each such transaction, private equity firms and their advisors must evaluate their potential merger control filing obligations in more than 160 jurisdictions. While each jurisdiction approaches merger control differently, private equity firms, in contrast to companies, typically face a common set of challenges across the globe due to their complex governance structures, extensive portfolio holdings and myriad investment structures. This article will discuss key global competition updates and considerations for private equity firms, including:

- Definitions of “control” and divergent views regarding a private equity firm’s economic group;
- Calculations of turnover, including for jointly controlled companies;
- Global developments in merger control, including major regime changes, focusing on transactions with minimal nexus to a jurisdiction; and
- Increased disclosures specifically for private equity firms in certain jurisdictions.

As such, private equity firms must be conscientious when analyzing filing obligations globally. Deliberate or accidental failure to submit mandatory notifications may result in costly penalties – both financial and reputational. With the ever-increasing scope of mandatory filing requirements, private equity firms must evaluate compliance in jurisdictions despite limited target presence or where the parties previously have not filed. Given the recent focus on technology, pharmaceutical and other start-up markets, where established regimes are reconsidering traditional turnover-based measures as the sole indicator of market presence, private equity firms must be cognizant of how their portfolio companies and acquisition targets may impact a particular market even though the revenue may be negligible.

II. EVALUATING JURISDICTIONAL THRESHOLDS

Navigating the merger control criteria for all relevant jurisdictions can be difficult not only because the rules are constantly changing, but also because the regimes often have varying approaches to similar concepts. Consider the simplest example – a private equity fund purchasing all of the voting stock of a target. Many jurisdictions use a two-part turnover test to determine whether a filing is necessary, analyzing the turnover of the acquiring party and its economic group on the one hand, and the turnover of the target on the other. This is largely where the similarities end, however, as jurisdictions have diverging definitions for the concepts of control, turnover and the calculation of turnover.

A. “Control” and the “Economic Group”

Assuming that a particular deal qualifies as a notifiable transaction under local law – a merger, share purchase, asset purchase or an amalgamation, depending on the jurisdiction – the parties involved must determine whether an acquiring party or parties will ultimately gain control over the target. Further complicating matters, many jurisdictions lack a target-specific threshold, only requiring that at least two parties exceed the given thresholds. This is particularly critical for private equity firms using bidding consortia to bear in mind because the European Union Merger Regulation, along with many other jurisdictions, can be triggered by two sponsors, both of whom meet the jurisdictional thresholds in the EU, obtaining control of an entity that does not have revenues in the EU.

With respect to a private equity firm, the relevant turnover typically consists of that generated by funds under common management and their controlled investments. Consider, however, the differences between the definitions of “control” in the U.S., Canada, the European Union, Brazil and China:

- In the United States, “control” is a bright-line test under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (“HSR Act”). Control of a non-corporate entity means having the right to at least 50 percent of the profits, or upon dissolution, assets of such entity, whereas control of a corporation means ownership of at least 50 percent of its outstanding voting securities or having the present contractual right to designate at least half of its board of directors. In an acquisition context, the entity which controls the acquiring entity and is not controlled by any other entity or person is the ultimate parent entity (“UPE”). In determining whether jurisdictional thresholds are met one looks to the turnover of the UPE and its controlled entities. Because of the very specific economic test of control, a private equity fund is often its own UPE even though the fund may be one of several sister entities all of which are engaged in investing and are commonly managed by the same general partner.

- In Canada, "control" likewise has a bright-line definition, which is similar to the definition in the United States. Control of a non-corporate entity means having the right to *more than* 50 percent of the profits, or upon dissolution, assets of such entity, whereas control of a corporation means ownership of more than 50 percent of the outstanding voting securities. Similar to the United States, a fund is often its own UPE. Typically, a fund will need to obtain information on the assets and revenues of the fund's worldwide "affiliates," which are typically issuers or entities owning or of which it owns more than 50 percent.

- In the EU, "control" is a more fluid concept, focusing on whether an entity exercises "decisive influence" through rights, contracts, or other means. Generally, these other means may include positive or negative control rights over key business decisions such as the budget, business plan, major investments or the appointment or dismissal of senior executives. Often, a fund's general partner (or ultimate general partner) exercises "decisive influence" over a private equity fund and certain of the fund's portfolio companies because the general partner makes the binding investment decisions for the fund the strategic decisions of the portfolio companies. In gathering turnover data, the firm must typically look across funds and their controlled portfolio holdings, the "economic group."

- In Brazil, while there is no explicit definition of "control," the Administrative Council of Economic Defense ("CADE"), the Brazilian competition authority, broadly views control as the ability to interfere/influence the commercial strategy of a company. Despite this somewhat amorphous standard, Brazil recently clarified that for private equity funds, only 50 percent holders of the fund are included in the same economic group as the fund itself for purposes of the thresholds assessment. As a result, in the context of a typical private equity fund that is widely-held, an economic group will consist of the fund and its 20 percent or greater owned entities, effectively severing the holdings of commonly managed funds.

- China's Anti-Monopoly Law also does not define "control." Instead, the Ministry of Commerce ("MOFCOM"), the Chinese authority charged with reviewing merger notifications, analyzes all facts including a party's contractual rights. While the result of this analysis is usually directionally consistent with that of the EU, MOFCOM has recently announced that it plans to issue definitive guidance on control, perhaps as early as this year. As with the EU, often the general partner (or ultimate general partner) of the investing fund is the controlling person and turnover will capture all controlled companies across funds that are under common ultimate management.

These varying approaches to control yield widely different results in a given merger control assessment. Consider the example of an alternative investment vehicle ("AIV") of a fund, an entity separate from the main partnership where a portion of the investor's capital is invested through the AIV for regulatory or tax purposes. Assume that the AIV in question is an entity which replicates the ownership of the fund but is not a subsidiary of the fund:

- In the U.S., under the very technical HSR definition of control, the AIV is likely its own UPE because there is no one with the requisite economic rights to at least 50 percent of the AIV, despite being commonly managed or sharing the same general partner;

- In Canada, whether an AIV is aggregated with the fund may depend on various factors, such as the distribution of interests in the AIV and the fund, as well as the structure of the transaction;

- In the EU, the AIV and the fund are typically considered to be part of the same economic group if the same ultimate general partner is making or has the right to make decisions for both; and

- In Brazil, generally the AIV is likely to be separate from the fund due to the recent changes with respect to control and investment funds.

For private equity firms, such divergent outcomes clearly impact whether jurisdictional thresholds are met across the globe and illustrate the importance of structure in private equity deals.

B. Calculation of "Turnover"

In the simplest of transactions – one buyer acquiring all of the voting securities of a single target – the relevant turnover of the acquirer is that of its economic group. Various jurisdictions, however, approach the calculation of turnover differently:

- Jointly-controlled entities: Where an entity shares control over a portfolio company with another shareholder, including, for example, in the EU where two shareholders may both be able to exercise "decisive influence" over a portfolio company, jurisdictions may attribute all or part of the company's turnover to each of its controlling shareholders. In jurisdictions such as Germany and Austria, the turnover generated by each controlling shareholder shall include 100 percent of the portfolio company's turnover. In the EU (under the EU Merger Regulation), in most circumstances a controlling shareholder that exercises joint control may apportion the turnover of the portfolio company based on the number of parties with which it shares control (e.g. where there are two controlling shareholders, 50 percent of the portfolio company's turnover would be attributed to each of the controlling shareholders).

- Affiliate or minority holding turnover: A couple of jurisdictions take into account the turnover of minority holdings when calculating total turnover for the economic group. For instance, in Austria local turnover generated by 25 percent or greater investments may be included in the economic group, regardless of whether the notifying party has "control" or exercises decisive influence over the particular portfolio company. Similarly, in Brazil the economic group for which the turnover is calculated includes all investments of at least 20 percent.

- Additions and subtractions: Many jurisdictions take divergent views on the mechanism for which parties must account for new investments and recent divestitures, including those taking place partway through the most recently-completed annual period. Due to the nature of the business, private equity companies must pay particular attention to when the purchase or sale of a portfolio company may alter the relevant turnover figures used to identify whether jurisdictional thresholds are tripped in any particular country.

Regardless of how a jurisdiction defines control for purposes of determining whether merger control filing thresholds are satisfied, many, if not all, will take a broader view of the group when conducting a substantive antitrust analysis.

III. UPDATES IN JURISDICTIONAL THRESHOLDS, PENALTIES AND DISCLOSURES

As regimes, even established ones, evolve and reevaluate prior policies and procedures to keep up with an ever-changing global economy, business models, and burgeoning industries, it is vitally important to keep abreast of changes. Small changes to jurisdictional thresholds, penalties, or disclosure requirements can significantly impact even the most sophisticated and veteran filer.

In the last several months, there have been significant changes and developments across the world:

- In the United States, the Premerger Notification Office ("PNO") of the Federal Trade Commission ("FTC") reversed its longstanding guidance with respect to Item 4(c) and Item 4(d) documents that address only foreign markets. Now, citing the increasingly interconnected global marketplace, the PNO requires parties to include such documents as responsive, thereby increasing the disclosure burden of filers. Additionally, the FTC recently increased the maximum allowable daily fine for a failure to notify under the HSR Act. The fine, which was $16,000 per day of non-compliance in 2016 and years prior, is now in excess of $40,000 per day.

- The EU and its Member States have long debated changes to merger control thresholds to address concerns regarding the ability of the European Commission ("EC") to review and evaluate all transactions that may lead to competition concerns, including minority transactions and those involving entities with low turnover that may not meet the technical jurisdictional thresholds. In response to Facebook's $22 billion acquisition of WhatsApp in 2014, the EC raised concerns that transactions involving technology start-ups, or other transactions whereby one party does not meet the turnover requirements in the EU, could nonetheless substantially effect competition in the EU. Further, the EC explored imposing a "size of transaction" jurisdictional threshold designed to capture large-scale mergers or acquisitions with a nexus to the EU that otherwise may not meet the existing revenue-based thresholds. Although the EC has yet to formally propose any changes, both Germany and Austria recently enacted similar amendments that are certain to increase the number of reportable transactions in those jurisdictions.

- A recent amendment to Germany's Act Against Restraints of Competition took effect on June 8, 2017, adding a size of transaction ("SOT") test to the German merger control regime. Although principally aimed at transactions involving start-ups, this new rule does not target specific industries. Under the new legislation, transactions are reportable in Germany if (1) the combined worldwide turnover of the parties exceeds EUR 500 million; (2) the German turnover of one party exceeds EUR 25 million, while no other party to the transaction has German turnover of more than EUR 5 million; (3) the consideration for the transaction exceeds EUR 400 million; and (4) the target is active in Germany "to a considerable extent." Although the standard for "active to a considerable extent" is undefined, comments to the legislation note that an online messaging platform with one million active users in Germany would be "active to a considerable extent," whereas a Canadian conglomerate selling its automotive business with German turnover below EUR 1 million would not. These examples highlight the intended target of these changes – the messaging platform example is a direct reference to the *Facebook-WhatsApp* transaction that involved innovative, data-heavy markets, whereas the Canadian automotive example reflects a more mature, stable market that is not the intended target of the rules.

- In Austria, a similar SOT test took effect on November 1, 2017. This new threshold applies to transactions where (1) the parties' combined worldwide turnover exceeds EUR 300 million, (2) the parties' combined Austrian turnover exceeds EUR 15 million, (3) the transaction consideration exceeds EUR 200 million, and (4) the target has "significant activities" in Austria. While "significant activities" in Austria is not explicitly defined, the explanatory notes of the legislation provide some insight. The notes indicate that "significant activities" may be assumed if the target has a business location in Austria, which may be determined based on generally recognized metrics in the respective industry. For instance, in the digital sector, monthly active users or a website's unique visitor count may be used to assess significant activity. Similar to Germany's amended thresholds, Austria's SOT threshold will likely impact real estate deals involving newly developed real estate with insignificant turnover but with a transaction value exceeding the SOT threshold, pharmaceutical companies with no or insignificant turnover but holding valuable pipeline products, and start-up companies in the digital space, including media and technology businesses that have a large number of users or a significant presence in Austria but that do not derive significant turnover in that country.

- In China, MOFCOM recently announced that new merger control measures may be released and enacted in the next year. Among the changes, MOFCOM indicated that it aims to clarify its definition of "control" given the current ambiguity. Currently, Chinese regulations broadly construe control, capturing acquisitions of less than 50 percent of a target where the acquiring party receives certain veto or approval rights. The clarification on control, and whether MOFCOM may extend its merger notification regime to minority acquisitions, will be an important development to monitor. MOFCOM has also indicated that it expects the new measures to provide it with authority to investigate smaller transactions that fall below the turnover thresholds. Although the mechanics of such authority remain to be seen, MOFCOM is expected to release proposed revisions to the merger control measures later this year.

- In Mexico, recent developments now require private equity firms to disclose the limited partners of their funds that hold an economic stake of more than 5 percent. Despite raising significant concerns with disclosing such private and typically well-guarded confidential information, the Federal Economic Competition Commission ("COFECE"), the Mexican competition authority, mandates reporting such sensitive information due to the authority's concerns over gaining greater disclosure about the nature and identity of the reporting and investing entities.

Throughout the rest of the world, several new merger control regimes have been announced or enacted, many of which may affect transactions for private equity companies with a global presence. Several jurisdictions have announced the implementation of merger control regimes in the last year, including Chile, Vietnam, the Philippines, Nigeria, among others.

- Chile has implemented a mandatory regime that requires notification where parties have a combined Chilean turnover of UF1.8 million (approximately $70 million) and each party has individual Chilean turnover of UF290,000 (approximately $10 million).

- Vietnam has issued draft legislation that proposes mandatory notification where the total transaction value is VND300 billion (approximately $13 million) or greater, one party has greater than a 20 percent market share or one party has Vietnamese turnover of VND 500 billion (approximately $23 million) or greater.

- The Philippines implemented a mandatory regime that requires notification where (1) the value of assets or aggregate annual gross revenues in, into or from the Philippines exceeds 1 billion Philippine pesos (approximately $21 million), (2) the transaction value exceeds 1 billion Philippine pesos (approximately $21 million), and (3) the acquiring entity will hold, as a result of the transaction, at least 35 percent of the voting securities of an issuer or have the right to at least 35 percent of the profits or, upon dissolution, assets of a non-corporate entity. In addition, despite initially requiring parties to file a merger notification pre-signing, recent changes to the regime now require a post-signing (but pre-closing) filing and the regime continues to undergo significant amendments.

- Nigeria has issued draft legislation that would create a new competition commission with authority to review mergers and mandate notification where the parties' combined turnover and assets are between 1 billion naira and 5 billion naira (approximately $3 million and $15 million).

IV. CONCLUSION

With such complex rules in key jurisdictions, including the increasing regulatory review of transactions in nascent regimes, private equity firms must implement a worldwide merger control strategy in order to obtain clearance for deals on a timely basis, even in the absence of substantive issues. Behind a wave of investment activity in the European market and the booming digital technology sector, additional rule changes seem inevitable. The amended thresholds in Germany and Austria exemplify the expanding scope of global merger control and private equity firms should expect to face potential filing obligations in a growing number of jurisdictions.