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EXPLANATORY NOTE: PROPOSED AMENDMENTS TO THE GUIDELINES ON MERGERS

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COMPETITION COMMISSION INVITES VIEWS OF STAKEHOLDERS ON PROPOSED AMENDMENTS TO THE COMPETITION COMMISSION GUIDELINES ON MERGERS

Introduction

The Competition Commission is considering amending the Competition Commission Guidelines on Mergers (hereinafter "the Merger Guidelines") and has today published the draft proposed amendments to two sections of the Merger Guidelines, namely control and failing firm. Interested parties are hereby invited to provide their views and comments on the proposed amendments.

The draft amended Guidelines can be accessed from this link.

This note provides a brief on the proposed amendments to the Merger Guidelines and explains the scope and objective of same.

Background

Section 38 of the Competition Act 2007 (hereinafter "the Act") requires the Commission to publish guidelines on the economic and legal analysis to be used for the assessment of restrictive business practices. In this respect, the Commission has issued various guidelines including one on Mergers, which provides for the assessment of merger situations.

Section 38(2) of the Act provides that the Competition Commission may *"…from time to time, review and publish the revised versions of, its guidelines and procedural rules"*. Pursuant to section 38(2) of the Act, the Competition Commission intends to amend two sections in the Merger Guidelines. It intends to amend the section relating to the treatment of control and bring a minor amendment to the section on failing firms.

Purpose of amendments

It has been observed that the provisions of the Merger Guidelines with respect to the meaning of control was not clear in its interpretation of the relevant section of the Act, namely section 47(c) of the Act. This may lead to uncertainties and ambiguities as to which transactions amount to a merger situation under the Act. It is important that the provision of the Merger Guidelines is clear to enable firms to take proper decisions and make proper assessments of merger transactions; the more so as merger notification is voluntary in Mauritius.

A sentence in the Merger Guidelines relating to failing firms may have two diverging interpretations and as such it is being proposed to remove this possible ambiguity.

The proposed amendments do not emanate from a change in the Act. They aim to provide clarity to the existing merger control provisions of the Act.

Amendments being Proposed

Control Provisions

Section 47(3) of the Act provides how a person may bring an enterprise under his control and is as follows:

> *"Any person may be treated as bringing an enterprise under his control where -*
>
> *a) he becomes able to control or materially to influence the policy of the enterprise, but without having a controlling interest in it;*
>
> *b) being already able to control or materially to influence the policy of the enterprise, he acquires a controlling interest in it; or*
>
> *c) being already able materially to influence the policy of the enterprise, he becomes able to control that policy".*

Section 47(3) of the Act sets 3 levels of controls namely "material influence", "control" (hereinafter referred as "de facto control") and "controlling interest". The manner in which the Merger Guidelines is currently drafted confuses these three levels of control and does not clearly differentiate between them.

The Merger Guidelines also do not make it clear that there are three **levels** of control and that any change in these levels of control can give rise to a new merger situation while the Act clearly provides for such possibility.

To this end, the Competition Commission proposes to delete current paragraphs 2.7 to 2.16 of the Merger Guidelines relating to control and replace same by detailed provisions on control through amended paragraphs 2.7 to 2.23. The proposed amendment will clarify, in line with the provision of the Act, that there are three distinct levels of control, namely material influence, de facto control and controlling interest, it will explain the criteria to assess these three levels of control, and will explain that any change in the level of control is deemed to be a change in control for the purposes of merger control under the Act. Annex I provides the proposed amendments.

Failing Firm Provisions

An assessment of whether a merger situation results in substantial lessening of competition is done by comparing the state of competition with the merger to the state of competition that would have prevailed without the merger. The state of competition that would have prevailed without the merger is referred to as the counterfactual. Paragraph 3.19 of the Merger Guidelines recognises "*that the counterfactual will be particularly important if one of the enterprises is held to be "failing"*". An assessment of whether the target is a failing firm is done in accordance with paragraph 3.20 of the Merger Guidelines.

Paragraph 3.19 of the Merger Guidelines provides that "*if a supplier is going out of business anyway, then there might be no loss of competition as a result of its being taken over, even by a close competitor, and even if the resulting market structure is highly uncompetitive*". This paragraph may have two interpretations. One interpretation is that when the target is a failing firm, then the transaction will in no circumstance result in substantial lessening of the competition. Another interpretation is that when the target is a failing firm, then under certain circumstances it will not result in substantial lessening of competition. The latter is the correct interpretation. To avoid any ambiguity, it is proposed to clarify this sentence. The proposed amendment is in Annex II.

The public consultation

Any person who wishes to respond to this public consultation is requested to provide its written comments and views, by **23rd July 2020**, to the Office of the Executive Director of the Competition Commission at 10th Floor, Hennessy Court, Cnr Suffren Road and Pope Hennessy Street, Port Louis or via email at info@competitioncommission.mu.

Annex I – Amendments proposed to the merger control provision of the Merger Guidelines

The Executive Director proposes to delete paragraphs 2.7 to 2.16 of the Merger Guidelines which are as below:

2.7 An enterprise is brought under the control of a person where –

a) The person becomes able to control or materially influence the policy of the enterprise, without having a controlling interest in it;

b) The person is able to control or materially influence the policy of the enterprise and in addition he acquires a controlling interest in it; or

c) A person is able to materially influence the policy of the enterprise, and he becomes able to control that policy.

2.8 The existence of control is determined by whether material influence is capable of being exercised, rather than the actual exercise of such influence. In determining whether material influence exists, the Competition Commission will consider all the relevant circumstances and not only the legal effect of any instrument, deed, transfer, assignment or other act.

Legal Control

2.9 Assessment of whether material influence is capable of being exercised requires a case-by-case analysis of the entire relationship between the merger parties. In making this assessment, the Competition Commission will have regard to all the circumstances of the case. The variety of commercial arrangements entered into by enterprises makes it difficult to state what will (or will not) give rise to material influence.

2.10 The Competition Commission considers that controlling interest is generally deemed to exist where a person holds:

a) ownership of at least 30% or more of the voting rights;

b) is able to control the composition of the board;

c) is in a position to exercise, or control the exercise of, more than one-half the maximum number of votes that can be exercised at a meeting of the company; or

d) holds 30% or more of the issued shares of the company, other than shares that carry no right to participate beyond a specified amount in a distribution of either profits or capital.

2.11 *The amount of 30% shareholding is however only indicative and control could potentially be established a level below this amount if other relevant factors provide strong evidence of control. Other forms of voting rights will also be taken into account in assessing controlling interest.*

De facto control

2.12 *Besides legal ownership through the acquisition of property rights and securities, de facto control may also be established. As there are no precise criteria for determining when an acquirer gains "de facto" control of an enterprise's policies, a case-by-case approach in the light of the particular circumstances will be adopted.*

2.13 *In assessing whether a party has de facto control over an enterprise, the Competition Commission may also consider whether any additional agreements with the enterprise allow the party to influence the enterprise's policies that affect its key strategic commercial behaviour. These might include the provision of consultancy services to the targeted enterprise or might, in certain circumstances, include agreements between enterprises that one will cease production and source all its requirements from the other.*

2.14 *Financial arrangements may confer material influence where the conditions are such that an enterprise becomes so dependent on the lender that the lender gains material influence over the enterprise's policies or activities (for example where the lender threatens to withdraw loan facilities if a particular activity is not pursued, or where the loan conditions confer on the lender the ability to exercise rights over and above those necessary to protect its investment, say, by options to take control of the enterprise or veto rights over certain strategic decisions). The Competition Commission is likely to be concerned with such financial arrangements only when the loan takes a larger strategic purpose which goes beyond that of protecting the lender's interest and has an effect on competition.*

2.15 *An option to purchase or convert shares cannot, in and of itself, confer control unless the option will be exercised in the near future according to legally binding agreements. However, the likely exercise of such an option can be taken into account as an additional factor, which together with other factors, may lead to the conclusion that control exists.*

2.16 *Control may exist where minority shareholders have additional rights which allow them to veto decisions that are essential for the strategic commercial behaviour of the enterprise, such as budget, business plans, major investments, the appointment of senior management or market–specific rights. The latter would include decisions on technology to be used where technology is a key feature of the merged enterprise. In markets characterized by market differentiation and a significant degree of innovation, a veto right over decisions in relation to new product lines to be developed may also be an important element in establishing control.*

And to replace same by the following amended paragraphs 2.7 to 2.23

Acquisition of control

2.7 Section 47(3) of the Act provides that a person may bring an enterprise under his control where-

a) he becomes able to control or materially to influence the policy of the enterprise, but without having a controlling interest in it;

b) being already able to control or materially to influence the policy of the enterprise, he acquires a controlling interest in it; or

c) being already able materially to influence the policy of the enterprise, he becomes able to control that policy.

2.8 Based on the above provision, three levels of control can be identified, namely material influence, de facto control (referred as control above) and controlling interest. Material influence is the lowest level of control, followed by de facto control, while controlling interest is the highest level of control. Any change in the level of control will be considered to amount to a new control and may lead to a new merger situation. For instance, if enterprise A had material influence over enterprise B and now increases its shareholding in B such that it now has controlling interest, this may be considered as a merger situation.

2.9 The Act does not define material influence, de facto control and controlling interest, but they are well established in competition law.

Material influence

2.10 Section 47(3)(a) of the Act provides that a person may acquire control where "he becomes able to control or materially to influence the policy of the enterprise, but without having a controlling interest in it". Material influence is the lowest level of control which may be conferred upon a person. This level of control refers to the ability of the acquirer to influence to a material extent the policy of the target which affects the target's behaviour on the market. To determine whether material influence exists, the Competition Commission will consider whether material influence is capable of being exercised, rather than the actual exercise of such influence. It is important to note that for the purposes of assessing material influence, the test is whether the acquirer has the ability to influence and not whether it has the ability to determine the policy of the target.

2.11 To this end, the Competition Commission will conduct a case by case analysis focusing on the overall relationship between the acquirer and the target along with the acquirer's ability to exercise the influence to determine whether material influence exists.

2.12 The acquirer's ability to influence the target's policy can arise through the exercise of votes at shareholders' meetings, together with any additional supporting factors that might suggest that the acquirer exercises an influence disproportionate to its shareholding.

2.13 Generally, the Competition Commission will consider shareholdings which confer voting rights of 25% and above, which normally confer ability to veto special resolutions, as likely to confer material influence, unless evidence demonstrates otherwise. Shareholdings of below 25% together with other rights or circumstances may also confer material influence.

2.14 A minority shareholding may confer material influence with regards to the activities of an enterprise, where the minority shareholding confers upon the person, rights which allow him to either take or veto decisions which relate to the commercial policy of the enterprise. This control is also known as negative control. Such rights include for instance, the right to veto or block special resolutions, the right to appoint directors on the Board and or the right to veto decisions which relate to budget, pricing, business plans, the introduction of a new product on the market, commencing a new line of business, marketing strategy, discontinuing any line of activity or other decisions which relate to the commercial policy of the enterprise on the market.

2.15 The right to appoint directors on the board of the target may in itself confer material influence. Another relevant factor which may confer material influence relates to the status and expertise of the acquirer in the field of commercial activities of the target and the corresponding level of influence he may exercise on the target.

2.16 It is recognized that material influence does not confer upon the acquirer the ability to control the policy of the target but to materially influence such policy. This is factored during assessment of the effect of such transactions on competition.

De facto control

2.17 Section 47(3)(a) provides that a person can obtain control where "he becomes able to control or materially to influence the policy of the enterprise, but without having a controlling interest in it". Section 47(3)(c) further provides that a person can obtain control where "being already able materially to influence the policy of the enterprise, he becomes able to control that policy".

2.18 "De facto" control is a control level which lies between material influence and controlling interest. It occurs where a person who despite holding a level of shareholding which confers 50% or lower voting rights, can control the target. This level of control means that the acquirer despite not having controlling interest becomes the controller of the company.

2.19 Similar to material influence, the Act poses no specific shareholding threshold to determine when a person will obtain de facto control. The Competition Commission will therefore conduct the assessment as to whether the person is able to control the policy of the target on a case-by-case basis considering the particular circumstances of the case.

2.20 In assessing whether a person has de facto control over an enterprise, the Competition Commission may also consider whether there exist any additional agreements which allow the person to control the enterprise's policies that affect its key strategic commercial behaviour.

Controlling interest

2.21 Section 47(3)(b) establishes the highest level of control which may be gained on an enterprise. It provides that a person may bring an enterprise under his control where "being already able to control or materially to influence the policy of the enterprise, he acquires a controlling interest in it". This control is referred to as controlling interest or legal control. The acquisition of a shareholding exceeding 50% of voting rights generally confers controlling interest.

2.22 Having more than 50% shareholding, makes the person the majority shareholder and as such, typically, only one shareholder can have controlling interest in an enterprise.

Changes in control

2.23 Following provisions of Section 47(3) of the Act, any change in the level of control held by a person into a new one may create a new merger situation.

2.24 For instance, a change from material influence to de facto control may be considered a new acquisition of control and may lead to a new merger situation. Similarly, a change from de facto control or material influence to controlling interest may be considered as a new acquisition of control. The Competition Commission will for that purpose conduct a case to case assessment to determine if there has been a change in the quality of control and subject to the three control thresholds.

2.25 The Act also provides for consideration of control by a group of persons. Therefore, for the purposes of assessing control over an enterprise, the Competition Commission can give consideration to control held by a group of persons.

Annex II - Amendments proposed to the failing firm provision of the Merger Guidelines

The Executive Director proposes to delete paragraph 3.19 of the Merger Guidelines which is as below:

3.19 *The counterfactual will be particularly important if one of the enterprises is held to be "failing". If a supplier is going out of business anyway, then there might be no loss of competition as a result of its being taken over, even by a close competitor, and even if the resulting market structure is highly uncompetitive. As with any merger, the Commission will clear such a merger, if it believes that there is no loss of competition compared to what would otherwise have happened.*

And to replace same by the following amended paragraph 3.19

3.19 The counterfactual will be particularly important if one of the enterprises is held to be "failing". If an enterprise is going out of business anyway, then subject to certain conditions as explained in paragraph 3.20, there is the possibility that there will be no loss of competition as a result of it being taken over, even by a close competitor. As with any merger, the Commission will clear such a merger, if it believes that there is no loss of competition compared to what would otherwise have happened.