Discussion Points

Presented by the Business and Industry Advisory Committee (BIAC) to the OECD Competition Committee
Working Party No. 3 on Co-operation and Enforcement

“Antitrust Issues Involving Minority Shareholding and Interlocking Directorates”

19 February 2008

1. **Introduction**

1. The Business and Advisory Committee (BIAC) to the OECD appreciates the opportunity to submit these comments to the OECD Competition Committee’s Working Party No. 3 (WP3) for its roundtable on “Antitrust Issues Involving Minority Shareholding and Interlocking Directorates” on 19 February 2008.

2. Industry does recognize that minority shareholdings can have an influence on the policy of companies. This is obviously true of minority shareholders who exercise joint control in joint ventures, but some form of influence can also be exercised through so-called “passive” shareholdings where no access to the corporate governance bodies, such as seats at the Board of Directors or contractual veto rights, is provided. The latter situations are themselves usually regulated by corporate law, providing for example disclosure obligations in respect of share ownership beyond certain thresholds or shareholders agreements, or shareholders approval of agreements between companies having interlocking directors.

3. Passive minority shareholders being in a position to exercise influence is probably a trend which has increased recently. Indeed a more active participation of minority shareholders is generally encouraged as part of the worldwide effort to improve corporate governance practices. This was for instance one of the themes developed by the “Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe”\(^1\). BIAC is of course in support of that movement for proactive minority shareholders. On the other hand, the well-publicised growing influence of funds, both as a result of the multiplication and size of their investments and because of their willingness to play a more active role, is also an important development. Private equity funds reportedly raised more than $400 billion of investment capital in 2006 alone, and spent nearly twice that much - over $740 billion - on

corporate buyouts. Thus, BIAC views this topic to be particularly timely for study by the Working Party.

4. Industry also recognises that such influence of minority shareholders can have anti-competitive effects in some circumstances. Economic literature and practical experience show that it is not uncommon that a company holds a minority share in another with which it has market relations, whether in horizontal or vertical situations and that in certain cases these shareholdings are reciprocal. Situations in which a third party (e.g. an investment fund) owns minority shareholdings in undertakings having between themselves horizontal competitive or vertical relationships are also not infrequent. Cross-shareholdings can be found in sectors as diverse as banking, insurance, energy, air travel and automotive. There are usually perfectly valid reasons for these situations: the preference of investors for sectors that they know well, the need for a transition stage in a progressive divestiture scheme, the desire to give equity support to a legitimate co-operation agreement, etc. One can quote a case where (admittedly in very specific circumstances) competition authorities themselves have recognized that minority shareholdings by competitors (including a dominant market player) can have pro-competitive effects (the *Blokker/Toys"R"Us* decision of the European Commission).

5. It is therefore not in dispute that in certain circumstances a minority shareholder can have an influence that is not restricted to the protection of its investment, but extends to the determination of the company’s market policy. And, even if the investment remains passive, i.e. not supported by interlocking directorship (reciprocal or not) or veto rights, this can lead to express or tacit collusion.

6. Accordingly, BIAC has no objection in principle to the basic positions taken by the U.S., the European Union and certain national competition authorities regarding their ability to investigate and regulate the potential anti-competitive effects of minority shareholding and interlocking directorates, as they result respectively from the application of Section 7 of the Clayton Act (and in some cases Section 1 of the Sherman Act), the so-called “Philip Morris doctrine” in its continued enforcement and certain national regulations like the German Act against Restraints to Competition.

7. Nor does BIAC object in principle to the applicability of competition law to minority-owning funds. This was recently confirmed in Europe by the Commission’s Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings of 10 July 2007 (para. 14 and 15). Similarly in the US there have been noted cases such as *Kinder Morgan*, and the recent filing of a civil action by the DOJ against ValueAct Capital Partners, a powerful reminder that the Clayton Act is applicable to financial investors. BIAC understands however that the funds may have worries as to a possible misconception of the nature of the “control” they exercise by virtue of their shareholdings, which may lead to indiscriminate appraisal of their levels of ownership in the calculation of thresholds for merger notification purposes, but it seems that at least the above-referenced Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings of 10 July 2007 (para. 14 and 15).

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Notice recognises that the variety of the forms under which they exercise control or influence must be analysed in detail.

8. It is important, in this regard, to note that competition agency enforcement is appropriate in those circumstances where legitimate concerns about impacts on competition are likely to occur as a result of cross ownership. The likelihood of such an adverse effect occurring can be measured against well known merger standards. Typically, this would require either (1) the removal of a key barrier to coordination in the industry, or (2) a likely unilateral effect that would provide an incentive for the parties to limit the extent of their competition. In the context of cross-ownership interests, the circumstances in which such effects can be expected are limited and, indeed, extremely unlikely where an investor owns a minority interest in both of the competing companies. In any event, even in cases where investors are competitors of the target firm, anti-competitive effects could only arise in highly-concentrated markets.

9. Enforcement action may also be appropriate in situations where there is a high risk of “spillover collusion” due to interlocking directorates or significant involvement in management of competing companies. In this regard, however, we would note that spillover collusion should not be presumed to result from cross-ownership where that ownership is passive with respect to at least one of the companies at issue.

10. Finally, a safe harbour can be established where the investment is passive – i.e., where it is both small in relation to the overall shareholding of the company and does not result in the direct involvement by the investor on either the board of directors or in the day to day management of the company.

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II. Clarification of European and National Laws and Policies Would Benefit Investment

11. A clarification of the policy with respect to the permissibility of cross-ownership and agency enforcement intentions would benefit investment, and thereby enhance consumer welfare. Uncertainty in this area creates the risk that investors will withhold funds that might usefully be placed into increasing innovation, reducing costs and otherwise enhancing competitiveness of firms.

12. A four part methodology would be most beneficial. This would consist of: (1) clear guidance on the *de minimis* thresholds of investment that will not result in agency scrutiny or concern; (2) an explanation of the circumstances under which the agency will deem cross-ownership interests to constitute a threat to competition; (3) an indication of the circumstances under which the agency will challenge cross-directorships between corporations, including subsidiaries and affiliates; and (4) an indication of the potentially acceptable remedies considered if it is found that the minority shareholding can indeed have anti-competitive effects.

13. The United States exhibits a relatively clear instance of three of these policies. First, the Hart-Scott-Rodino Act (Section 7A of the Clayton Act) provides for an “investment only” exemption that serves, in effect, as a safe harbour for partial equity investors. Under this regulation, an acquisition of voting securities is “exempt from the requirements of the act [...] if made solely for the purpose of investment and if, as a result of the acquisition, the acquiring person would hold ten percent or less of the outstanding voting securities of the issuer, regardless of the dollar value of voting securities so acquired or held.”\(^6\) Second, Section 7 the Clayton Act and the enforcement actions of the agencies provides relatively precise guidance as to the thresholds at which the agencies will challenge cross-ownership interests. The agencies take a strict view on cross-ownership among competitors, generally prohibiting the practice in such matters under its review, except in those cases where the cross ownership pre-dates the horizontal competition or where the relationship among the parties also bears elements of pro-competitive vertical integration\(^7\). In such cases, the agencies generally will permit a *de minimis* level of cross-ownership with a nominal cap of 10%. Third, Section 8 of the Clayton Act is clear on the question of interlocking directorates and the level at which such matters are considered *de minimis*. The basic prohibition restricts any person from serving as an officer or director of any two corporations which “by virtue of their business and location of operation, competitors, so that the elimination of competition by agreement between them would constitute a violation of any of the antitrust laws.” This effectively restricts interlocks among any two companies that compete at any level. The narrow *de minimis* exception applies if (1) the competitive sales of either corporation are less than $2,531,900; (2) the competitive sales of either corporation are less than 2 per centum of that corporation's total sales; or (3) the competitive sales of each corporation are less than 4% of that corporation's total sales\(^8\).

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\(^7\) See, e.g., United States v. Univision Communications, Inc., http://www.usdoj.gov/atr/cases/f202100/202184.htm

\(^8\) 73 Fed. Reg. 5192 (Jan. 29, 2008), see also http://www.ftc.gov/opa/2008/01/clayton.shtm
14. While BIAC regards the threshold levels established by the U.S. laws and policies, in general, to be too stringent and therefore potentially inhibiting of pro-competitive investment, we nonetheless recognize the approach to be comprehensive and clear. In particular, BIAC views the “investment only” threshold of the HSR statute, and the *de minimis* threshold of the Clayton Act – both of which were established decades ago without the benefit of economic learning on the subject – as being far too low to reflect current economic and institutional thinking. Short of outright cartel agreements, the construct under which such arrangements are likely to harm competition at this level (principally unilateral effects concerns) exist only in a theoretical vacuum. The confluence of own price elasticities, sales diversion levels and lack of competitive alternatives that would have to exist in order to support such competitive harm are unlikely to occur in any real world settings.

15. In Canada, critics point out that it is difficult to know why the acquisition of a 20% interest in a public company triggers a notification obligation while the higher threshold of 35% applies to investments in closely-held companies (while in addition the Merger Enforcement Guidelines adopt the view that any equity investment of 10% or more will be reviewed as the acquisition of a "significant interest").

16. There are probably more problems in European jurisdictions where companies face a variety of sometimes inconsistent policies. It is clear and acceptable that minority stakes that confer control are concentrations under the Merger Regulation, but the situation is less satisfactory when the minority stake does not confer control. It has been pointed out by several authors that there are pieces missing in the European Commission’s jigsaw. While the Philip Morris doctrine makes it clear that a non-controlling minority shareholding can be used to anti-competitive effects, there is no specific tool to enforce the doctrine. Case law shows that such situations have been analysed either in application of the Merger Regulation although it came into force after the Philip Morris case (*Tetra Laval/Sidel*, *Eurostar*, *Toshiba/Westinghouse*), article 81 (*BT/MCI*, *Olivetti/Digital*, *Hudson’s Bay/Finnish Fur Sales “Hudson’s Bay II”*) and article 82 of the Treaty of Rome (*Warner-Lambert/Gillette*). These three “tools” pursue different purposes, which does not help consistency. Moreover, there might be instances where none of the three apply, respectively because there is no “change in control”, no “agreement between undertakings” (or, more broadly, no co-ordinated effect), and no dominant position.

17. There are also apparent contradictions in the application of EC law. In some cases the minority shareholding is viewed as a danger requiring remedies or even result in the failure of a transaction. However, that is not to say that minority shareholdings by competitors are always viewed in a negative light like in *Warner-Lambert/Gillette*: in others they are viewed as

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9 Commission decision Case No COMP/M. 2416 *Tetra Laval/Sidel*


11 COMP/M.4153 (2007/C 10/01)


16 Ibid.
harmless or even pro-competitive\textsuperscript{17}. Unfortunately, it is not possible to see in the series of decisions a clear trend attributable to the differences in the levels of the stakes held by the minority shareholders, nor to the nature of their contractual rights. The new Consolidated Jurisdictional Notice, which focuses on the concept of “control”, does not bring much additional clarity on the subject of “influence”, and this was perhaps a missed opportunity.

18. Uncertainties and contradictions can also be found in the enforcement by national authorities: in particular, it seems odd that Germany and Austria (together with Lithuania according to the accepted interpretation of the law) should stand alone in imposing a notification obligation for acquisitions of minority shareholdings above 25\% (irrespective of the rights conferred on the holder of the stake, and of market circumstances), while also stating that the acquisition of a “competitively significant influence” qualifies as a concentration. Poland, which had a similar rule, removed it in 2007.

19. It is then not surprising that the business community, always in search of legal certainty, should consider the necessity of guidelines to clarify both the nature of the situations which require analysis and the range of remedies to be considered if it is found that the minority shareholding can indeed have anti-competitive effects.

20. However the business community is also always wary of over-regulation and increased burdens on undertakings, and it may be argued that yet another set of guidelines, even if not binding, is useless. There seems to be remarkably few litigation cases in Germany, denoting a small number of competition issues related to minority shareholdings, despite the large number of filings generated by the extensive criteria of the Act against Restraints of Competition. The apparent contradictions pointed out above may simply reflect the variety in the legal regimes of Member States and the particular circumstances of each individual case, especially as the number of cases at hand is rather small. Finally, where there has been an attempt to provide guidelines, like for instance in the Substantive Assessment Guidance document for Mergers published by the UK’s Office of Fair Trading, they give little more than general common sense advice and preserve maximum flexibility.

\textsuperscript{17} See above note 3
III. The Potential Contents of Guidelines

21. BIAC considers that, while steering clear of a per se approach, the European Commission should issue some form of guidelines, if only to make sure that national agencies across Europe apply consistent policies. BIAC further submits that, at the very least, these guidelines should meet the following criteria.

22. Again, one should remain wary of over-regulation and increased burdens on undertakings, and not impose unnecessary new notification requirements. Hence a preference for guidelines: a Commission Notice could be the appropriate tool, or perhaps more simply an amendment to the Consolidated Jurisdictional Notice rather than an amendment to the Merger Regulation, as suggested by some authors\(^\text{18}\). Also, it is likely that taking the route of the amending to the Regulation would almost inevitably affect the concept of control which is one of the bases of the Merger Regulation, thus creating fresh legal uncertainty.

23. One should also remain conscious of the fact that in its decision-making process, the investor is confronted with various concepts of control, which are not limited to competition law approaches to concentration and have different consequences not only depending on jurisdiction, but also on the area of the law under consideration. Indeed when preparing a potential investment decision, the investor often begins its analysis by assessing the consequences from a consolidation point of view, which if plain majority control or joint control is not reached may imply an analysis of “significant influence” under the specific criteria of accounting rules, which is assumed when the interest in voting rights is superior to 20% and determines the application of the so-called equity accounting method. On the other hand, in corporate law various interest thresholds draw various consequences, and they differ from country to country. For instance minority interests above 5% in the U.K., 10% in Germany and approximately 0.50% for large listed companies in France permit minority shareholders to submit resolutions at shareholders meetings. Qualified majorities required for certain “qualified resolutions” (including generally any modifications to the by-laws) give minority shareholders with shareholding exceeding 25% in the U.K. and Germany, 33.3% in France the right to veto such resolutions. The stock exchange regulations impose certain obligations of disclosure and even the compulsory submission of bid offers above certain interest thresholds, again not the same in all countries: 30% in the U.K. or Germany, 33.3% in France. Even when specific thresholds are not set by corporate law, the concept of directors’ fiduciary duty is in itself a strong obstacle to interlocking directorates between competitors. Criminal law also draws consequences from the holding of certain minority stakes above certain thresholds: under the Third “anti-laundering” European Directive, a 25% (plus one share) ownership in a legal entity is deemed equivalent to “control” and may trigger disclosure requirements\(^\text{19}\). Finally, tax law derives various consequences from various minority ownership levels. All these non-antitrust limitations help reducing the number of situations where anti-competitive minority “influence” can develop. Adding a new series of obligations specific to competition law purely because certain minority thresholds are crossed (as it is the case in Germany or Austria) would unnecessarily increase the administrative burden on undertakings.

24. If guidelines are issued, they should certainly not be limited to the definition of rigid thresholds in terms of percentage of interest above which there would be a presumption of “influence” of


the minority shareholder over the company. It is not simply that, where they exist in current legislation, these thresholds are too low: one can even question the relevance of quoting shareholding levels in itself. If we consider the German/Austrian position, commentators often complain that the plain 25% criterion (which admittedly would provide by itself a formidable degree of legal certainty) ends up imposing filing obligations in many cases where the transaction has no potential effect on competition. Understandably, the law has been drafted in such a way as to permit the competition authorities to investigate the acquisition of a smaller interest in circumstances where, due to the presence of additional factors likely to confer a “competitively significant influence”, they deem it appropriate to review a particular transaction more closely. This of course does reduce the legal certainty advantage. In the U.K. as well, there is a 25% threshold, applied in a different manner, since although there is a presumption of “material influence” irrespective of the status of the rest of the company’s equity the notification remains voluntary. But the OFT Guidelines also quote a 15% threshold above which such influence can be exercised under certain circumstances, and reserves the OFT’s right to investigate “occasionally” under that latter threshold. Indeed acquisitions of a shareholding of less than 10% have on rare occasions been examined by the UK regulators; however, these did involve media mergers and neither resulted in a prohibition decision (BSkyB/Leeds Sporting, NTL/Newcastle United). Despite the rather comprehensive and clear definition of the factors that the OFT takes in consideration to assess the material influence, all this does not give a safe harbour, or even much practical guidance, to the investor.

25. In any case, if interest percentage thresholds are defined because of their attractiveness from a legal certainty point of view, they should be used in conjunction with an analysis of the level of concentration on the market, since in the (rare) cases where anti-competitive effects of minority shareholding and interlocking directorates may be observed, it is in oligopoly circumstances. Tools do exist to bring a level of reliability to this kind of analysis (HHI) and would be appropriate in horizontal competition situations, but they should be used with a high degree of flexibility.

26. A more useful approach would be to provide guidance focusing on the assessment of “influence”, in order to restrict investigation and enforcement to those circumstances where legitimate concerns about impacts on competition are likely to occur as a result of the minority ownership. This is especially topical as the national authorities’ approach to the concept seems to vary: does the British “material influence” differ from the German “competitively significant influence”? This assessment should inevitably take stock of the conceptual efforts made to define “joint control” by the Commission itself in its Consolidated Jurisdictional Notice. U.S. and German case law probably provide a useful analysis of the various tools (directorship, veto rights, access to information) that can confer such influence. But guidelines would greatly help the investors in finding their way since case law provided by European and national authorities and courts is for the moment insufficient.

27. The same flexibility is required with respect to the guidance which is required as to the range of available remedies if it is established that the minority shareholding can have anti-competitive effects. While divestiture is less dramatic for a minority holding than for a merger, U.S. practice

20 “Mergers-Substantive Assessment Guidance”, May 2003
21 Decision of the OFT of 3 February 2000, published on the Regulatory News Service
22 Competition Commission Report on the Merger Situation, presented to Parliament by the Secretary of State for Trade and Industry by Command of Her Majesty, July 1999
23 See A. Ezrachi and D. Gilo, loc.cit., 346.
shows it is generally unnecessary, and it should remain a last resort solution, particularly given the risk of serious losses being incurred. The remedies should therefore focus on the rights granted to the minority shareholder by the operation of law (to the extent they can be waived) or contractually. The panel of available measures is well known: limitation of veto rights to subjects directly related to investment protection, forbidding interlocking directorates, “firewalls” to prevent the flow of sensitive market information, etc. In doing so however, the influence of a director’s seat on decision-making or exchange of information should not be overrated: in large companies, boards are by nature confined to high-level decisions, remote from the details of the market, and the exchange of information between competitors is increasingly under the competition authorities’ watch anyway. It should be kept in mind that, to be efficient, “firewall” provisions should be carefully drafted.

28. BIAC is conscious of the difficulty in finding a happy medium between legal certainty in a system relying on rigid thresholds and/or a list of legal factors triggering a presumption of “competitively significant influence”, which inevitably results in a number of unnecessary notifications, and the need to take into account complex and very diverse sets of circumstances. Of course no legal regime will ever accommodate the wide range of shapes and forms that acquisitions of minority shareholdings can take. However, that does not mean that the current regimes (whether at European or national level) could not be improved, and we would encourage the European competition authorities to initially at least recognize the need for clarification and consistency.