Competition - European Union

Beyond EU merger control

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Companies which operate in the same industrial sector often merge in order to increase their market presence. Although the point is rarely made, in undertaking such transactions, such companies also seek to increase their market power. Merger control rules are designed to prevent companies from gaining a dominant position through M&A activity. Consequently, it would seem reasonable for a purchaser to think that, having obtained merger control consent for an acquisition (assuming such consent was required), it would be free to proceed with business and realise the value of the transaction. However, would-be purchasers should be aware of two developments when valuing a prospective transaction in light of the potential for regulatory interference, post-transaction, with the combined businesses.

The first development is a proactive approach to an old issue. It is well known that, in the European Union, the abuse of a dominant position is prohibited. However, as the Court of Justice of the European Union recognised in its *Telia/Sonera* ruling in February 2011, the European Commission's Competition Directorate (ie, the EU competition authority) may take action "before the anti-competitive effects of a strategy are realised". Joaquín Almunia, the European Commission's commissioner responsible for competition, referenced this ruling on September 16 2011 in a speech in which he spoke about an investigation into allegations that Google has abused its dominant position in the online search sector, thereby violating Article 102 of the Treaty on the Functioning of the European Union. The opening of formal proceedings followed complaints by online search service providers about unfavourable treatment of their services in Google's unpaid and sponsored search results, coupled with an alleged preferential placement of Google's own services. The commissioner stated that "the Google case is...a good example [with which to demonstrate] that timely intervention is crucial in fast-moving technology markets". In reality, few corporations have the luxury of being in a dominant position and those that are in such a position are aware of that fact (although this is perhaps less true in dynamic markets such as those in the information and communications technology sector). The commissioner's ready use of the court's statement in *Telia/Sonera* prompts the question: would Google have paid $3.1 billion to acquire DoubleClick in 2008 had it known at the time that the acquisition was likely to trigger an abuse of dominance case?

The second development falls outside the scope of EU competition law, but will have a significant impact on EU competition policy. The European Commission and other regulatory bodies – in exasperation or, perhaps, desperation – have turned to regulatory and legislative tools to achieve what would have proved extremely difficult or impossible using competition rules. An example of this concerns companies that are regarded as being 'too big to fail'. The first casualty was the Dutch financial conglomerate ING Group, which was broken up by regulators in October 2009. The final report of the UK Independent Commission on Banking, published in September 2011, is likely to have a more significant impact. Lloyds Bank will be required to divest more than 600 branches in order to allow "the emergence of a strong challenger bank". In addition, all the larger retail banks will be ring-fenced from their investment banking operations. As a result, according to the *Financial Times* on September 12 2011:

"*UK banks are expected to incur additional annual costs of up to £7 billion to comply with the commission's proposals, which will make those affected by both the ring fencing and competition proposals riskier shareholdings*".

This again prompts questions as to valuation of acquisitions and share value in concentrated markets.

On September 26 2011 the European Commission issued a proposal in relation to audit firms. The proposal has attracted significant attention in the press and is an example of how the European Union can seek to change the competitive landscape through means other than merger control rules. The proposal would prohibit auditors of publicly listed corporations from providing services other than the statutory audit to the relevant corporation. Such a prohibition would constitute a severe limitation on the growth of accountancy firms' non-audit services. In addition, large publicly listed corporations would be required to appoint a second non-major audit firm to undertake the annual audit (a 'non-major audit firm' being defined as one with less than 15% of audit fees from large publicly listed corporations in the relevant EU member state). The clear intention is to support such 'second-tier' audit firms to break the glass ceiling which is perceived to exist in relation to the 'big four' audit firms. Michel Barnier, the commissioner for the internal market, is leading the proposal. He noted in a speech in June 2011 (while the commission was drafting the proposal) that:

"*recent concentration developments in the sector have not escaped my attention, both in Europe PWC is currently acquiring Grant Thornton in Denmark and elsewhere KPMG's recent acquisition of BDO in Brazil. The acquisition by the big four of firms belonging to medium-sized groups is cause for concern*."

The abovementioned developments demonstrate that the valuation of potential M&A transactions in already concentrated markets is becoming more difficult as the European Commission and EU member state governments introduce regulation which is beyond the usual rules of merger control. Potential purchasers would be well advised to consider the implications of these developments before entering into M&A transactions.

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