

Venture Capital Funds and Merger Control

All corporate and commercial activity across Europe – including venture capital investment – takes place within a framework of European and national laws designed to protect competition. In the context of acquisitions of shareholdings or businesses, merger control rules can apply to certain deals at European or local national levels.

In the vast majority of cases, because of the 'start up' nature of the target, the types of investment made by venture capital funds in new businesses will not actively engage either European or national **merger control rules**. However, in certain circumstances, such deals may require approval either from the European Commission or from national regulators.

When will a Venture Capital deal require merger control approval?

A deal must be notified to the European Commission where:

- it will result in a **change of control** of the target; and
- the parties meet specific **turnover thresholds**.

If the deal is not notifiable to the European Commission, it may still need to be notified to national merger control regulators in Europe. In the UK for example, a deal may be notifiable to the Office of Fair Trading where:

- two or more enterprises will be **brought under common control**; and either
- a specific **turnover threshold** (currently £70m) is met by the target; or
- after the merger, the parties will increase their share of the supply of any goods or services in the UK to **25% or more**.

What is 'control' according to the European merger rules?

A venture capital fund will acquire control in a target company when it acquires 'decisive influence' over the target. Decisive influence may occur in the following situations.

- **Acquisition of shares.** Usually an acquisition of a majority shareholding in the target. However, decisive influence can occur with shareholdings as low as 34%.
- **Obtaining control over the board of directors.** This will allow the fund to control the day-to-day activity of the target.
- **Obtaining veto rights.** By holding certain veto rights over the business plan of the target, or other key strategic business decisions, the fund will be able to control the target's activities.

What is 'control' according to the UK merger rules?

A venture capital fund will acquire control in a target company if it acquires at least 'material influence' over the target. Material influence may occur in any of the following situations.

- **Acquisition of shares.** Obtaining a 15-25% shareholding.
- **Possession of significant expertise in the industry.** Where in practice a fund holds such significant industry knowledge that its advice is, or would be, followed by the target in nearly all cases.
- **Board representation.** Certain levels of board representation will allow the fund to directly influence management decisions.
- **Obtaining veto powers.** If a fund holds special veto powers over the target's business which go beyond what is normal for a shareholder at its level of investment.

What should you do if your deal may result in a change of control?

If the fund will acquire 'control' for the purposes of European or UK merger legislation, then further analysis is required in order to assess whether the merger control rules apply.

- **Breakdown of turnover.** The turnover of the parties to the deal will need to be analysed on a worldwide, European, and national basis. The relevant parties for this exercise are at least the target, the fund, and all the companies in which the fund currently possesses a majority shareholding.
- **Market share analysis.** In the UK, the market share of the target, together with the degree of overlap between the activities of the target and the fund (plus its portfolio companies), will need to be assessed in order to understand whether a notification should be made in the UK.

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Consequences of non-notification

Most merger control regimes are mandatory. If the thresholds are triggered, then a notification must be made to the relevant regulator.

The consequences of non-notification can vary from country to country. However, in most cases they will include the following.

- **Financial penalties.** The European Commission, for example, in a recent case fined a company €20m for completing a merger without first notifying it to the Commission.
- **Interim measures.** A merger control regulator may investigate the deal following its completion. In such cases, a regulator may be able to order that, during the investigation, the parties

'hold separate' the merging businesses pending a decision. This can cause considerable disruption to the businesses and prompt the departure of key employees.

- **Unwinding the deal.** Ultimately, if the regulator takes a negative view of the transaction, it can require the complete unwinding of the merger or other measures in order to return the market to its pre-merger condition.

The UK's merger control regime, in contrast with many across Europe, is voluntary. However, where the Office of Fair Trading decides that it has jurisdiction to examine a merger, it may investigate that transaction for up to several months after completion, and may order interim measures and/or eventually unwind the deal.

How we can help

We can advise you on the full range of European merger control issues.

- Whether a merger control threshold would be triggered by a venture capital deal.
- How to restructure a deal to avoid merger control notifications.
- The prospects of obtaining merger control approval for the deal.
- How to get the deal successfully approved by merger control regulators.

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