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**COMPETITION COMMITTEE**

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## Working Party No. 3 on Co-operation and Enforcement

**DEFINITION OF TRANSACTION FOR THE PURPOSE OF MERGER CONTROL REVIEW**

**-- Hungary --**

**18 June 2013**

*The attached document is submitted to Working Party No. 3 of the Competition Committee FOR DISCUSSION under item IV of the agenda at its forthcoming meeting on 18 June 2013.*

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**English - Or. English**

## 1. Definition of a merger transaction

1. According to the Hungarian Competition Act[1] a concentration of independent undertakings occurs in the following situations:

- when two or more undertakings merge,
- when one undertaking purchases another undertaking (takeover),
- when a part of an undertaking becomes a part of another undertaking,
- when sole or joint control is acquired (direct or indirect control) of another undertaking or part of an undertaking,
- when the undertakings create an undertaking that is controlled by them, which is able to perform on a long term basis all the functions of an independent undertaking.

2. Concerning acquisition of control the Competition Act specifies control as the following:

- the ownership of the interests or shares of another undertaking entitling them to exercise majority voting rights, or are holders of more than fifty per cent of the voting rights;
- the right to appoint, elect or recall the majority of the executive officials,
- the entitlement by contracts
- and the ability on a factual basis to exercise decisive influence on the decisions of another undertaking.

3. The definition of a concentration has gradually evolved as amendments have been made to the Competition Act, and has been further refined by the practice of the Competition.

4. According to the practice of the Competition Council, for the existence of a merger it makes no difference whether control was acquired by one or several transactions, provided that the end result constitutes a single concentration. This also means that various transactions can result in one concentration if they are connected to each other in such a manner that none of the transactions would take place without the others. Only if one business activity, i.e. one economic entity, is involved in the acquisition by several inter-conditional legal transactions can it be considered as one merger regardless of whether the interdependent transactions are considered as acquisition of control or not, or whether the sellers belong to the same groups of undertakings.

5. The long term nature of the control does not form part of the legal definition, the Competition Act specifies the exemption of temporary - for a one-year period at the longest - acquisitions of control by financial companies for the purpose of preparing a resale, provided that they do not exercise their controlling rights, or exercise them only to an extent which is indispensable to the attainment of these objectives.

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[1] The Hungarian Competition Act (Act LVII of 1996 on the prohibition of unfair and restrictive market practices):
http://www.gvh.hu/gvh/alpha?do=2&st=2&pg=129&m5_doc=4244&m176_act=2
Chapter VI Control of Concentration of Undertakings (23-32 §§) and 15 § undertakings not independent of each other.

6. The aim of merger control is to monitor the long term lasting changes that occur in the market structure. The GVH evaluates on a case by case basis weather the acquisition of control can be considered to be long lasting. According to the practice of the GVH, the minimum period of time above which a concentration may arise is not defined. For certain contracts a time period of 5+2 years was sufficient to establish the long-term acquisition of control.

7. Hungarian merger control is based on a **mandatory preliminary authorisation system**. The authorisation of the GVH is required for the merger of any undertakings with a turnover that is higher than the threshold that is contained in the Competition Act. The application for authorisation must be submitted within thirty days of the date of the publication of the invitation to tender, the conclusion of the contract or the acquisition of the controlling rights, whichever of them is the earliest. If the undertakings fail to apply to the GVH for the authorisation of their merger, the GVH may launch a proceeding ex officio.

8. The GVH does authorise a concrete contract in its procedure, but a concentration in terms of the Competition Act, so there are no legal obstacles to prevent the GVH from investigating the linking contracts that per se led to a merger in a procedure. According to the practice of the GVH, two or more transactions can be judged in the same procedure, if they belong to the same economic activity, the companies involved on both sides form a single economic unit and there is no significant difference between the date of the transactions. Therefore, the GVH authorises a series of transactions in one procedure if a maximum of 30 days has elapsed between the first and last step of the process.

## 2. Thresholds

9. The Hungarian Competition Act that is currently in force only defines the revenue threshold. For a concentration of undertakings, the authorisation of the Hungarian Competition Authority must be sought in cases where the aggregate net turnover of all the groups of undertakings concerned exceeded 15 billion HUF (ca. 52 million EUR) in the preceding business year, and the net turnover of each of at least two of the groups of undertakings concerned was more than 500 million HUF (increment of ca. 1.7 million EUR). The current Competition Act contains no market share threshold.

### *2.1 The two year buy-up rule – 'gaming the system'*

10. The authorisation obligation exists, if the group of undertaking implemented another – not applicable - merger within two years prior to the merger of more than 500 million HUF.

11. With the two year buy-up rule the legislator wished to avoid a situation where the smaller transactions – which do not effect competition on the market – fall under merger control unnecessarily. However, these small steps can be harmful to competition if they become the continuing business practice of the undertaking. For this reason, the Competition Act prescribes that in assessing whether the 500 million HUF threshold is met, concentrations not subject to authorisation which took place within a two-year period preceding the concentration concerned between the same group of undertakings shall also be taken into account.

## 3. De facto control (minority interests, interlocking directorates, veto rights)

12. The Hungarian Competition Act contains no thresholds on acquisition of minority shareholding.

13. **De facto control** can be established in all cases when the owner of the minority votes - for some reason - could reasonably expect to obtain the majority of the votes in the shareholders' meeting.

14. There is no general rule laid down in the Competition Act on the percentage of shares or business assets which determine de facto control as it depends on the actual circumstances of the given case. The GVH investigates the acquisition of control or the establishment of de facto control on a case by case basis.

15. The typical situations in which de facto control is exercised through minority shares are the following:

- the largest minority shareholder's share is significantly larger than the second biggest minority shareholder's share and there is a large number of fragmented shares (in this case the Competition Council examines the actual participation on the past general meetings);
- besides the minority shareholder there is another significant shareholder that is not likely to take part in the management of the company (financial investor).

16. When one shareholder is able to veto the strategic decisions of an undertaking, this can result in **negative sole control.** Such negative sole control is distinguished from positive sole control in that the controlling undertaking does not have the power on his own to impose strategic decisions and can only block the decision making process. In contrast to joint control, there are no other shareholders that are able to block the adoption of strategic decisions. If one stakeholder owns 50% of the shares in an undertaking and the remaining 50% is held by several other shareholders, the general meeting of the shareholders cannot make a decision without the shareholder who possesses 50% of the shares. This means that this shareholder is able to influence the decisions of the undertaking.

17. Control on a de facto basis may also occur if an undertaking actually has the **majority of the representatives on the decision-making bodies** of the controlled undertaking. However, such a situation can arise at any time (for example, when an executive official resigns), so control on a de facto basis only occurs when it is likely that the situation results in lasting change.

## 4. Part of an undertaking

18. The definition of the part of an undertaking is based on the concept that a concentration is connected primarily to the products (services) and not to the undertakings.

19. The Competition Act defines "part of an undertaking" as assets or rights, including the clientele of an undertaking, the acquisition of which, solely or together with assets and rights which are at the disposal of the acquiring undertaking, is sufficient to enable market activities to be pursued (so the transaction results the change of the concentration).

20. According to the practice of the GVH – in contrast to the practice of the European Commission - it makes no difference whether the acquirer of a part of an undertaking is actually conducting or could conduct business activity only for the seller or for itself, it is enough that the assets or rights to be transferred alone or together with assets and rights available for the buyer are sufficient for conducting business activity.

21. The GVH recently investigated in several cases what criteria need to be met for taking over control of a part of an undertaking. The situations established by these cases, which were about transferring (selling or leasing) retail stores, were the following:

- the acquisition of the property of the real estate, assets and employees
- the long-term leasing of the real estate, the acquisition of assets and employees,
- the acquisition of the property of the real estate of a closed store and assets.

22. In a case of a leasing of an already closed mall, the Competition Council took into consideration the facts that the buyer had acquired the leasing rights of the mall right after it had closed, and the acquirer conducted the same business activity. The short term of closing and the same business activity created „goodwill" related to the real estate, which together with the assets and rights which are at the disposal of the acquiring undertaking, were sufficient for enabling market activities to be pursued.

23. According to the practice of the Competition Council, transferring licenses of trademarks is also considered as a merger case, because such transfers influence the market structure and concentration.

## 5. Joint ventures

24. A sub-type of merger transactions is where two or more independent undertakings create a joint venture. However, only a joint venture that performs on a long term basis all of the functions of an autonomous entity (a so called full-function joint venture) shall constitute a concentration. A full-function joint venture (as in the practice of the European Commission) must have a management that is dedicated to its everyday operations and must also have access to sufficient resources, including finance, staff, and assets in order to conduct on a long term basis its business activities within the area provided for in the joint-venture agreement.

25. The Hungarian Competition Council has specified the criteria that must be fulfilled by full-function joint ventures. The full-function joint venture

- should be able to perform the same functions that are normally carried out by other undertakings on the same market (market presence in an operational sense)

- has to have sufficient tangible and intangible assets to produce goods and services in the relevant market, has to have a management for everyday operations, and has to have resources including finance, staff and assets, and in some cases official authorisation.

26. A joint venture does not constitute a full-function joint venture if its business activities are permanently and essentially limited to its parent companies. Also, if the purpose of a joint venture is limited to the acquisition of control over other companies and the maintenance of indirect joint control of parent companies, it is not considered as a full-function joint venture.

As full-function joint ventures are considered as mergers, their founders have to apply for authorisation if their net incomes fulfill the thresholds that are set out in the Competition Act.

Non-full-function joint ventures are not considered as mergers and the Competition Authority evaluates them on the basis of IV chapter of the Competition Act, the Prohibition of Agreements Restricting Economic Competition.

### *5.1 Exercising joint control*

27. According to the practice of the Competition Council, an undertaking is jointly controlled when the parent companies exercise their controlling rights, which are set out in the Competition Act, jointly.

28. Joint control exists

- where there are only two parent companies which share equally (50:50) the voting rights in the joint venture, assuming that the operating rules of the decision-making bodies provide for equality in voting rights.

- where a company has two shareholders, and one of them has the majority of voting rights and the other one has the right to appoint members to the decision-making bodies (even in the absence of a formal agreement on control)
- where a formal agreement exists between the parent companies, for example providing for veto rights for the minority shareholder over the strategic business decisions or over a decisive element of business strategy, so that the decisions determining the business activity of the joint venture cannot be accepted without the consent of the owner of the veto rights.

29. Where a situation of joint control exists the parent companies have to reach an agreement on all relevant questions related to the business activity of the controlled undertaking. The existence of joint control can be established either on the basis of objective situation or on the basis of a formal agreement that has been concluded between the parent companies. Such an objective situation does not exist when the joint venture has four shareholders, which equally own 25% of the shares. In this case it is not only necessary, but also sufficient in order to reach a decision, if three shareholders reach an agreement, and this may occur in four different combinations.

### *5.2 Reduction in number of shareholders*

30. Interestingly, contrary to the practice of the European Commission, in Hungary a reduction in the number of jointly controlling undertakings constitutes a notifiable concentration as an acquisition of control of the reduced number of shareholders. [2]

31. On the one hand, the GVH's practice is the result of the EC Regulation that states "a reduction in the number of controlling shareholders constitutes a change in the quality of control and is thus to be considered as a concentration (…)". Thus it cannot be excluded that a reduction in the number of shareholders will result in a change in the quality of the control and will affect economic competition.

32. On the other hand, Hungarian merger control is based on a **mandatory preliminary authorisation system** and failure to notify is penalised by the GVH as an infringement. So there should not remain any uncertainty about whether a specific type of transaction constitutes a concentration.

33. As part of the authorisation process, the GVH examines whether the reduction in the number of shareholders could result in a change to the quality of the control and in the market behaviour of the joint venture.

## 6. Exemptions

34. The Competition Act specifies two exemptions from the definition of concentration and the acquisition of control.

35. Temporary acquisitions of control or ownership for a maximum period of one year by financial companies for the purpose of preparing a resale are not considered **as concentrations**, if these financial companies do not exercise their controlling rights, or exercise them only to an extent which is indispensable to the attainment of these objectives. The Hungarian Competition Authority may, on request, extend the period of time where undertakings can show that it was not possible to carry out the disposal within one year.

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[2] Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (2008/C 95/01) para (90).

36. Activities of an office-holder relating to the winding up and the dissolution of undertakings **do not qualify as** the exercise of control.

## 7. Changes in the Merger Regime

37. The following table shows the evolution of the concept of a concentration in the Hungarian legal system.

| | First Competition Act[3] | Competition Act[4] | Amendment of year 2000 | Amendment of year 2005 |
|---|---|---|---|---|
| **Definition of concentration** | Organisational merger, Acquisition of single legal control | Organisational merger, Acquisition of single and joint legal control, Part of an undertaking, Joint venture | Organisational merger, Acquisition of single and joint legal and de facto control, Part of an undertaking, Joint venture | Organisational merger, Acquisition of single and joint legal and de facto control, Part of an undertaking, Joint venture, Undertakings not independent of each other, Modification of the buy-up rule |
| **Thresholds** | Turnover (aggregate net turnover of the undertakings concerned over 10 billion HUF) **or** market share (of 30%) | Turnover (aggregate net turnover of the undertakings concerned over 10 billion HUF, aggregate turnover of min. 2 undertakings over 500 million HUF) | Turnover (aggregate net turnover of the undertakings concerned over 10 billion HUF, aggregate turnover of min. 2 undertakings over 500 million HUF) | Turnover (aggregate net turnover of the undertakings concerned over 15 billion HUF, aggregate turnover of min. 2 undertakings over 500 million HUF) |

### *7.1. Definition of a concentration*

38. The first Competition Act defined a concentration as either an organisational merger or the acquisition of single legal control. The current Competition Act provides definitions for an acquisition of single and joint legal control, for a part of an undertaking, and for a joint venture. Finally the amendment of year 2000 brought the acquisition of de facto control into the definition of a concentration.

39. The definition of "undertakings not independent of each other" which is specified in Chapter IV, Prohibition of Agreements Restricting Economic Competition also belongs to the merger regulation of the

[3] Act LXXXVI of 1990 on the Prohibition of Unfair Market Practices

[4] Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices

Competition Act. The definition from 2005 is basically the same as the direct and indirect participants of a concentration, except for one special case.

40. In case of undertakings with majority state or municipality ownership the managing relation is not a sufficient condition for the non-independence. The independence of these undertakings only can be assessed on the basis of the analysis of the actual operations. If the undertaking possesses autonomous decision-making powers in determining the market conduct, it shall be deemed to be independent of the owner. When establishing who possesses the decision-making powers for determining the market conduct, the Competition Council examines which undertaking has the right to adopt the business plan.

### *7.2. Thresholds*

41. The first competition law tied the authorisation application requirement to the aggregate net turnover of the undertakings (10 billion HUF, ca. 34.5 million EUR) or to a market share of 30%.

42. The Competition Act that is currently in force only defines the revenue threshold. For a concentration of undertakings, the authorisation of the Hungarian Competition Authority must be sought in cases where the aggregate net turnover of all the groups of undertakings concerned exceeded 15 billion HUF (ca. 52 million EUR) in the preceding business year, and the net turnover of each of at least two of the groups of undertakings concerned was more than 500 million HUF (ca. 1.7 million EUR). Before 2005, the aggregate net turnover threshold was 10 billion HUF.

43. Before the amendments of 2005, when assessing whether the 500 million HUF threshold was met, all concentrations which took place within a two-year period preceding the concentration concerned had to also be taken into account. This rule had a wider scope of application than the EC Regulation. According to the EC Regulation only the transactions that are not subject to authorisation - between the same groups of undertakings - should be brought together in one procedure.

44. The option of implementing the EC rules was raised in 2001, but it was not done, in order to keep the possibility to control the then-current cable network acquisitions. By the year of 2005, the current cable network acquisitions were accomplished, so there was no reason to maintain the regulation. In 2005 the legislator thought that it was unnecessary to maintain a regulation that results in redundant proceedings and that is also contrary to the EC regulation in order to manage the specific problems of a profession.

45. Since 2005, the Competition Act has stated that when assessing whether the 500 million HUF threshold is met, concentrations *not subject to authorisation* which took place within a two-year period preceding the concentration concerned *between the same groups of undertakings,* shall also be taken into account.

### *7.3. Professional regulations, professional administrative proceedings*

46. At present the Medicinal Products Act contains a special prohibition on buy-ups[5], as a concentration shall not be authorised if

- it would give a business association or company group, or the same natural person, control over more than four pharmacies
- it would a given business association or company group, or the same natural person, control over three or more pharmacies in a community with a population of less than twenty thousand.

[5] Act XCVIII of 2006 on the General Provisions Relating to the Reliable and Economically Feasible Supply of Medicinal Products and Medical Aids and on the Distribution of Medicinal Products (75. §)

47. In accordance with the Media Law that was adopted in 2010, the Hungarian Competition Authority shall obtain the opinion of the Media Council for the approval of a concentration of enterprises when at least two of the relevant groups of undertakings bear editorial responsibility and the primary objective of which is to distribute media content to the general public via an electronic communications network or a printed press product.[6] This administrative procedure is designed to ensure media pluralism, by securing the right of diverse orientation in case of merger of independent sources.

48. The official assessment of the Media Council shall be binding upon the Competition Authority, however, this fact does not prevent the Competition Authority from prohibiting a merger from being concluded that has already been officially approved by the Media Council, irrespective of any condition the Media Council may have imposed, or from imposing a condition or an obligation contained in the Competition Act that the Media Council has failed to impose.

### *7.4. De facto control (minority interests, interlocking directorates, veto rights)*

49. The acquisition of "de facto" control has been introduced into the Competition Act alongside the other three earlier defined methods of acquisition of control (the ownership of the interests or shares which entitle their owners to exercise majority voting rights, or more than fifty per cent of the voting rights, the entitlement to appoint, elect or recall the majority of the executive officials of another undertaking, and the entitlement by contracts to exercise decisive influence on the decisions of another undertaking).

### *7.5. Part of an undertaking*

50. The concept of a part of an undertaking was introduced into the Competition Act in 2000, as the definition of a concentration broadened with the acquisition of control over a part of an undertaking.

### *7.6. Joint ventures*

51. Under the legislation that was in force before November 2005, only a (so-called concentrative) joint venture constituted a merger in which founders combined their same or complementary activities. Such a transaction obviously increases the concentration of the relevant activities, despite the fact that the number of operators is not reduced but increased. A joint venture meeting the above mentioned conditions is considered as a merger, if it does not constitute an agreement restricting economic competition.

52. Amendments to the 2005 Competition Act clarified the scope of the joint ventures qualifying as mergers. Since the 2005 Amendment only those joint ventures that can perform all the functions of an autonomous enterprise (full-function joint ventures) are considered as concentrations. The full-function joint venture has

- a management dedicated to its everyday operations;
- access to sufficient resources, including finance, staff, and assets; in order to
- conduct on a long term basis its business activities within the area provided for in the joint-venture agreement

## 8. Alternatives

53. In the practice of the GVH, the legal definition of a merger has never been extended to include anti-competitive agreements.

6 Act CLXXXV of 2010 on Media Services and on the Mass Media (171. §)