CLIFFORD CHANCE

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# Merger Controls – Reminder for Real Estate Joint Ventures

**Key Issues**



**Joint ventures are an increasingly common feature of the European real estate landscape. Investors are seeking to share the risks and rewards of investment, developers are being incentivised with equity-based "promotes" and lenders are swapping distressed debt for equity positions.**

One aspect that is often overlooked during negotiations is the potential application of merger controls to the joint venture. Merger controls can apply even in circumstances where the transaction is not one on which the authorities would normally be expected to take any action, such as a development project. Failure to comply with the relevant requirements can lead to significant sanctions including fines of up to a maximum of ten percent of the aggregate worldwide turnover of the parties involved in the transaction.

## EU Controls and Local Controls

Mergers throughout the European Union are governed by a combination of the European Commission (the "Commission") and the competition authorities of the individual Member States. If the transaction satisfies certain criteria, the relevant parties must notify the Commission who will then have exclusive jurisdiction (rather than the competition authorities of any Member State).

However, even if the transaction does not require notification to the Commission, national EU Member State merger controls may still apply. With the exception of the UK (where pre-closing notification is voluntary unless the authorities choose to intervene) and Luxembourg (which has no national merger control) filings in all other EU Member States are mandatory if certain thresholds relating to degree of control and size of transaction are met. Generally, the transaction must also have some potential to affect competition in the relevant Member State.

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## When must the Commission be Notified

There are a number of tests that determine whether a transaction involving a joint venture will need to be notified to the Commission including whether the joint venture is "full function" (see Glossary of Terms below for a detailed explanation of this term) and whether the transaction results in a change of control (see Glossary below).

A key test is whether the transaction exceeds certain thresholds in respect of the turnover of the transaction parties. There are two alternative thresholds and if either is surpassed then the transaction must be notified to the Commission. The diagram on page 3 provides an outline of the thresholds but for further details of how the test is applied including how turnover is calculated and who the relevant parties are please contact us.

A key point to note is that turnover is calculated on an aggregated group basis which means that each party's turnover includes the turnover of its ultimate parent company, along with all that company's subsidiary undertakings. This means that where a transaction involves any subsidiaries of large entities such as a bank or other financial institutions then it is relatively easy to exceed the turnover thresholds even if the actual joint venture is only relatively low value.

## The Notification Process

The notification process is time-consuming and involves a significant amount of data collection. For example information on the parties and the market data for the markets in which they operate. Critically, the transaction cannot be completed until the notification process has been completed and the Commission has declared that the transaction is "compatible with the common market".

The Commission has 25 working-days from receipt of the notification to carry out its initial assessment of the transaction and although the majority of transactions are cleared after this phase, in difficult cases the Commission has an additional 90 working-day period to carry out a more detailed assessment. As a result, it is important to identify transactions that may potentially require notification at an early stage so that they can be properly assessed and, if necessary, the potential impact on the timetable taken into account. This is particularly important where the notification requirement might significantly delay the exercise of key rights under the joint venture agreement (such as a right to buy out or to dilute a defaulting partner) and therefore render such rights ineffective in practice.

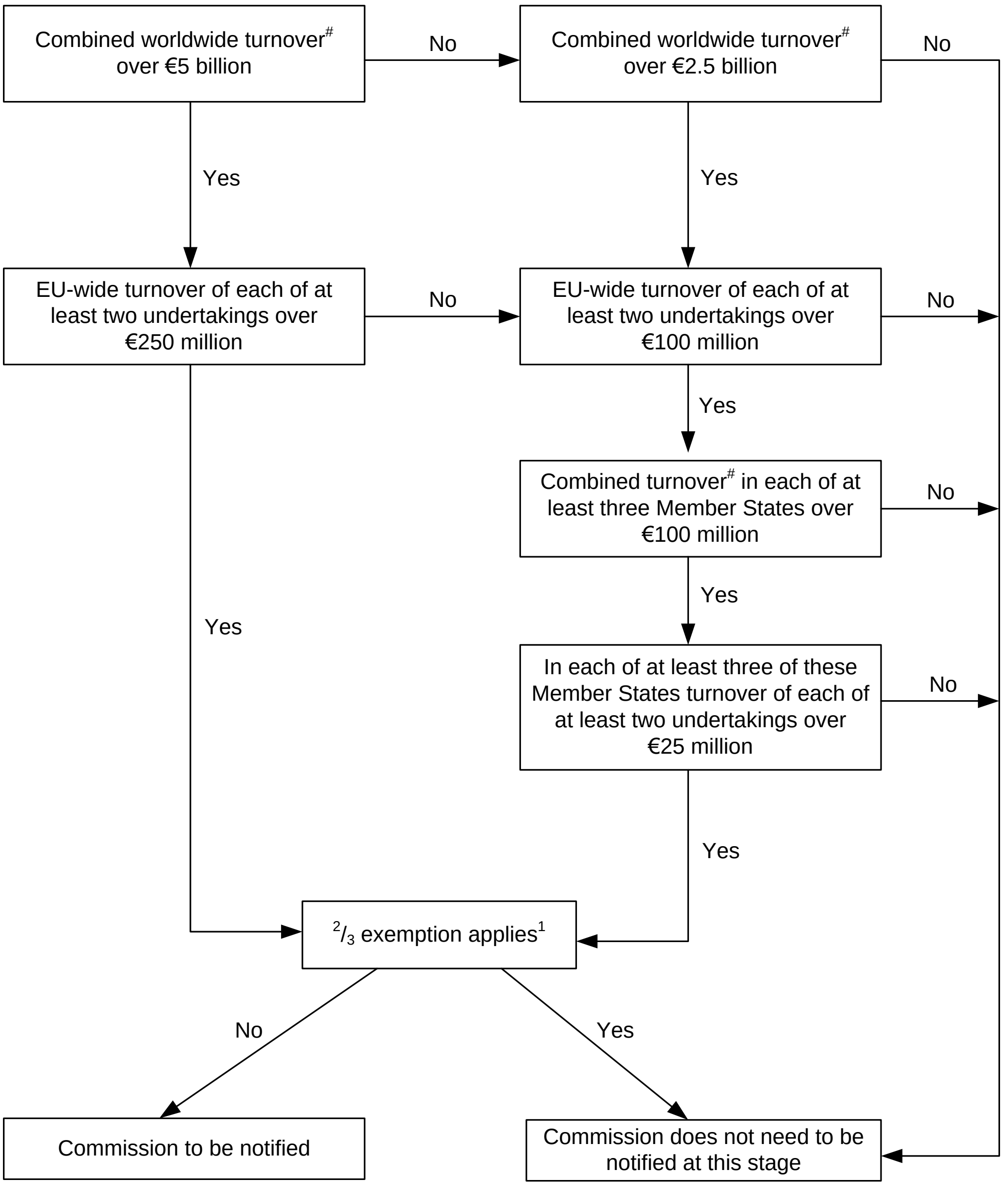
In addition to the delay and additional costs, the notification process can have confidentiality implications as the Commission will place brief details on its website, including the names of the parties, the sectors in which they are active and a short description of the transaction.

## Glossary of Terms

**Full Function** : A "full-function" joint venture is one which performs all the functions of an autonomous economic entity. Each joint venture needs to be assessed based on the specific facts but if the joint venture is set-up simply to acquire and hold property using the financial resources of the parties establishing the joint venture then it will not usually be considered as full function joint venture. This is in contrast to a joint venture established to actively manage a portfolio of real-estate assets and which acts in the market under its own identity.

**Change in Control** : A party will acquire control over a joint venture where it gains "the possibility of exercising decisive influence" over the joint venture. "Decisive influence" is a low threshold and can include even simple veto rights in respect of key decisions, such as approving the joint venture's business plan, approving key investments or appointing senior management.

As well as the obvious situations such as following an acquisitions or disposals or on the establishment of a new joint venture, a change of control can occur on the introduction or expulsion of joint venture partners and even as a result of a changes in the rights and relationships of the parties such as where one joint venture partner "dilutes" another's interest.




# All undertakings concerned

1. This applies if each of the undertakings achieves more than two thirds of its turnover with the same Member State.