Case-note to Case T-3/93, Société Anonyme à Participation Ouvrière Compagnie Nationale Air France v. Commission of the European Communities [1994] ECR II-121

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Case T-3/93, *Société Anonyme à Participation Ouvrière Compagnie Nationale Air France* v. *Commission of the European Communities*, [1994] ECR II-121.

1. Introduction

In 1992, British Airways (hereinafter BA) acquired the British airline company Dan Air and the French airline company TAT European Airlines. Both acquisitions constituted concentrations within the meaning of the Merger Control Regulation.[1] However, the Commission held that the acquisition of Dan Air did not come within the scope of the Regulation, and it issued a clearance decision with regard to the acquisition of TAT. These decisions prompted Air France to sue the Commission before the Court of First Instance.

On 24 March 1994 the CFI dismissed Air France's application in the Dan Air case. It seems, though, that the Court's ruling on the substantive issue of the case might have some consequences which have not been clearly foreseen. In this case note, I shall examine the ruling of the Court in order to identify these consequences.

2. Background

In 1992 Dan Air encountered severe problems. Therefore, on 23 October that year BA agreed to acquire Dan Air by paying £ 1 in consideration to the owner up till the acquisition, Davies and Newman Holdings plc.

BA's acquisition on 23 October was, however, conditional. BA did

1. Council Regulation (EEC) No. 4064/89 of 21 Dec. 1989 on the control of concentrations between undertakings (O.J. 1989, L 395, Corrigendum: O.J. 1990, L 257).

not want to acquire Dan Air's charter activities, so BA would only complete the acquisition if Dan Air could divest itself of these activities. During talks with the Commission, BA renounced its possibility of waiving this condition even though it had been left open in the agreement of 23 October.

The acquisition was eventually brought about on 8 November 1992. On the face of it this acquisition does not appear to be any different from the many other acquisitions which take place in Europe. Nonetheless, BA's acquisition of Dan Air should prove to be a little different.

During the negotiations the question arose as to whether the takeover would have to be approved by the European Commission or by the British Mergers and Monopolies Commission. The allocation of jurisdiction between on the one hand the Commission and on the other hand the Member State competition authorities is laid down in the Merger Control Regulation. The Regulation provides that concentrations with a Community dimension shall be subject to the exclusive jurisdiction of the Commission.[2] If, however, a concentration does not have a Community dimension, the Commission is precluded from examining it under the Regulation at its own initiative.

The acquisition of Dan Air clearly constituted a concentration within the meaning of the Regulation. It was, however, much less clear whether it also had a Community dimension. BA would only be obliged to notify the Commission of the concentration if this was the case.

The Regulation defines "Community dimension" in Article 1(2) in the following way:

> "For the purposes of this Regulation, a concentration has a Community dimension where:
>
> (a) the combined aggregate worldwide turnover of all the undertakings concerned is more than ECU 5000 million; and
>
> (b) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than ECU 250 million,

2. Cf. Art. 21(2)(1). Apparently, there is a misprint in the English language version of the Regulation on this point since the word "consideration" is used in place of "concentration". The German and the French versions seem to show that the term "concentration" is the correct one.

> unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State."

In the present case, the worldwide turnover fairly clearly exceeded ECU 5000 million and it was also fairly obvious that the two airline companies, operating internationally, would not achieve more than two-thirds of their Community-wide turnover in one and the same Member State. However, the requirement that at least two of the undertakings concerned must achieve more than ECU 250 million in the Community created significant problems.

BA very clearly met the ECU 250 million turnover threshold. The Regulation, however, requires that at least two undertakings concerned meet the threshold which meant that the other undertaking concerned, Dan Air, was also required to meet this threshold in order for the concentration to have a Community dimension.

Dan Air's accounts for the preceding financial year showed a Community-wide turnover of more than ECU 250 million. However, this figure included Dan Air's charter activities and the question was whether or not the turnover on these activities should be excluded.

Article 5(1) of the Regulation provides that when examining whether a concentration has a Community dimension the turnover "in the preceding financial year" of each of the undertakings concerned must be used. Hence, since in the preceding financial year Dan Air had a turnover of more than ECU 250 million, the starting point was that the concentration had a Community dimension.

However, Article 5(2) provides (*inter alia*) the following:

> "By way of derogation from paragraph 1, where the concentration consists in the acquisition of parts, whether or not constituted as legal entities, of one or more undertakings, only the turnover relating to the parts which are the subject of the transaction shall be taken into account with regard to the seller or sellers."

Did this mean that the charter activities of Dan Air would have to be deducted so that the concentration did not have a Community dimen-

sion? In order to solve this problem the lawyers advising on the concentration asked the Commission for advice.

On 30 October 1992 a spokesman for Sir Leon Brittan, then Commissioner for Competition, declared that the concentration did not have a Community dimension because the ECU 250 million threshold had not been met by Dan Air; thus the Commission could not intervene. This statement was reported by Agence Europe on 31 October 1992. On 2 November 1992 the concentration was cleared by the British authorities and on 8 November the transfer of the securities was brought about.

The next day, on 9 November, Air France sent a letter to the Commission challenging the latter's interpretation. The Commission remained firm on its interpretation and on 5 January 1993 Air France sued the Commission before the Court of First Instance requesting that the Commission's decision not to take jurisdiction should be annulled.

The Commission raised an objection of inadmissibility to Air France's action.

3. The Judgment of the Court of First Instance

The case gave rise to two distinct problems. A procedural one concerning the admissibility of the action and a substantive one concerning whether or not the Commission was right in declining to take jurisdiction. The procedural problem has been dealt with at length in an earlier case note in the Review[3] and I shall therefore restrict myself to the substantive issue of the judgment.

The Court first established that since BA's acquisition had been conditional upon Dan Air divesting itself of its charter activities and since BA had renounced to waive this condition BA had only acquired those of Dan Air's activities which did not include the charter activities.[4]

Thereupon, in para 102, the Court went on to establish that the general scheme of Article 5 of the Regulation shows that the Community legislature intended that the Commission should only intervene in a

3. See the case note by Toth, 32 CML Rev. 271–304.
4. Para 100 of the judgment.

concentration "where the proposed operation is of a certain economic size, that is to say, where it has a 'Community dimension'." It furthermore established that "[t]he objective of Article 5(2) of the Regulation is thus to determine the real dimension of the concentration for the purposes of examining whether, having regard to the parts of the undertaking which are actually acquired, whether or not constituted as legal entities, the proposed operation has a 'Community dimension'..."

Despite the fact that Article 5(2) does not contain an express reference to the discontinuance of activities the Court established that a "partial transfer" and a "partial discontinuance of activities" are comparable since "they both allow a precise appraisal to be made of the exact subject-matter, composition and extent of the proposed concentration." The Court therefore laid down the following interpretation of Article 5(2): "It follows that only the turnover relating to those parts of the undertaking which are actually acquired are to be taken into account for the purposes of appraising the dimension of the proposed operation. Consequently, reference should only be made to the turnover for the last financial year of those parts of the undertaking which are actually acquired."[5]

Applying this principle to the case in question led the Court to the conclusion that the charter activities of Dan Air were not to be taken into account and, accordingly, that the concentration did not possess a Community dimension.

Since Air France was not successful in its three other pleas either, the application for annulment was dismissed.

4. Comment

4.1 *Introduction*

Whether or not BA really did not take over "all of Dan Air" is a discussion which I shall not enter into here.[6] Instead I shall comment on the

5. Para 103 of the judgment.
6. The answer is not completely evident as will be apparent from the discussion there-

Court's interpretation of the notion of 'Community dimension' and I shall show some consequences of the chosen interpretation.

4.2 *The notion of Community dimension*

It is common ground that the notion of Community dimension is intended to achieve two aims.

Firstly, the thresholds are intended to *reflect the economic size* of the undertakings concerned by the concentration. Thus in its Notice on the calculation of turnover the Commission explains that "the world-wide turnover threshold is intended to measure the overall dimension of the undertakings concerned, the Community turnover threshold seeks to determine whether they carry on a minimum level of activities in the Community and the two-thirds rule aims to exclude purely domestic transactions from Community jurisdiction."[7]

Secondly, the thresholds are purely quantitative criteria which are often seen as providing *clarity* and of *leaving no scope for argument* at the cost of being very arbitrary. The Commission in its Notice on the calculation of turnover explains that "their aim is to provide a simple and objective mechanism that can be easily handled by the companies involved in a merger".[8]

In its judgment the Court emphasizes these two aims in its interpretation of Article 5(2).

4.3 *Article 5(2) of the Regulation*

Article 5(1) of the Regulation provides the main rule for how to calculate the turnover of the undertakings concerned in a concentration in order to ascertain whether the concentration has a Community dimen-

of in Broberg, "The European Commission's Jurisdiction under the Merger Control Regulation", 63 *Nordic Journal of International Law*, 17–108 at 37–38.

7. Para 3 of the Commission Notice on calculation of turnover, O.J. 1994, C 385/21–31.

8. Para 5 of the Commission Notice on calculation of turnover, *supra* note 7. See also Broberg, *supra* note 6, at p. 22 with note 16.

sion. According to this rule the aggregate turnover of the "preceding financial year" must be used. Using the *aggregate turnover* means that the full group-turnover of each of the undertakings concerned must be taken into account.

This rule may create problems because it would mean that any concentration between two large undertakings would be caught. For instance if Volkswagen wanted to sell an insignificant business unit to Shell this acquisition would be notifiable since it would constitute a concentration and since the turnover of the two parties would meet all the thresholds. In order to remedy this problem the drafters included Article 5(2). According to this provision, where an undertaking acquires parts of another undertaking only the turnover relating to the parts being subject to the transaction shall be taken into account with regard to the seller. This means that if Volkswagen sells a business unit generating sales of ECU 100,000 to Shell, then the requirement that at least two of the undertakings generate a Community-wide turnover of ECU 250 million will not be met.[9]

In the *Dan Air* case, Article 5(2) was applicable since BA only acquired Dan Air which formed only one business unit in the Davies & Newman Holdings group. Hence only the turnover generated by Dan Air would have to be taken into account.

By holding that discontinued activities should also be excluded from the calculation, however, the Commission and the Court went one step further in their interpretation of Article 5(2).

Where the closure of an activity has been effected so long ago that it is reflected in the accounts for the preceding financial year there is no problem. Where this is not the case the problem is that it is difficult, if not impossible, to state when a closure must be considered to be decisive: Is an interim closure of a production facility enough or must the closure be of a more permanent kind? Must the production facilities have been sold? And what if the production facilities can easily be acquired again? Must the intellectual property rights have been aban-

9. The drafters were aware that Art. 5(2) could lead to circumvention where the parties decided to split a concentration into more transactions, some or all of which would not have a Community dimension and thereby fall outside the scope of the Regulation. A special provision to counter this was therefore included in Art. 5(2)(2).

doned? Must (all) the liabilities and rights relating to this production have been finally settled? and so forth.

The Court restricts itself to stating that a partial discontinuance of activities "allow a precise appraisal to be made of the exact subject-matter, composition and extent of the proposed concentration."[10] It is, of course, true that in the *Dan Air* case, BA was required to renounce its right to waive the condition that Dan Air divested itself of its charter activities. This seems to show that some degree of certainty must be required. For instance a proposed interim closure of a production facility will probably not suffice, whereas an actual interim closure of a production facility before an acquisition does not seem to conflict with the judgment.

Hence, there is a stark contrast between the situation concerning a discontinuance of activities and the situation where a part has been sold by a seller which remains active. Moreover, almost all markets change from year to year: in one year the demand increases so that the employees must work in shifts or so that an extra production line must be opened, in the next year there is a contraction in demand so that a production line is closed down. Meanwhile the undertaking might close down in some geographic or product markets while starting in other geographic or product markets. The Court's ruling in the *Dan Air* case appears to cover all of these situations.

Matters may be complicated even more: if discontinuance of activities must be taken into account under Article 5(2) then logic requires that the start of new activities should be taken into account as well.[11] It is easy to see that this would make the calculation of turnover extremely complex and bring about a high degree of uncertainty. This would not accord very well with the aim that the thresholds should provide a clear division of jurisdiction so that there will be no scope for

10. Para 103 of the judgment.

11. Schroeder in *EEC Merger Control Reporter* (Kluwer, Deventer, 1991 and other years) at p. 460.2 (concerning another merger case) makes the following observation: "[T]here are limits to the extent to which new developments can be taken into account. If a company's sales grow naturally (not through acquisitions) between the preceding financial year and the concentration, there is no choice but to use the preceding financial year's turnover. The same applies when a company's sales go down so that on the basis of present sales there would be no Community dimension."

argument and the thresholds should be easy to apply in the real world.[12] Luckily, the Court's judgment only explicitly covers discontinuance of activities. It is therefore not difficult to construe the judgment in such a way that start of new activities since the end of the preceding financial year shall not be taken into account.

A further important observation is that where for instance an undertaking sells a subsidiary, the seller presumably remains active in the market and the parts which have not been sold therefore still constitute economic power. Thus it seems logical to make a distinction between the economic power acquired (the subsidiary) and the economic power which remains in the market (the seller). In the case of a discontinuance the situation is different. In the *Dan Air* case the seller, Davies & Newman, remained in the market and clearly should not be taken into account. However, while Dan Air returned all its slots relating to its charter flights, disposed of all its aircrafts providing charter flights, terminated its charter contracts and reduced its flight staff, none of these facts – viewed independently or together – necessarily means that a new economic power equal to the discontinued activities is created. Indeed there is no guarantee that for instance the slots are not later acquired by BA, that the aircrafts would remain grounded, etc. Put differently, there seems to be a very strong argument that all of the economic activities which could be "labelled" Dan Air were acquired by BA. In this way the *Dan Air* case differs fundamentally from the situation where one undertaking acquires a part of another undertaking.

On the basis of the above examination the Court's interpretation may appear a little surprising.[13]

12. Bos, Stuyck and Wytinck, "Concentration Control in the European Economic Community" (London, Graham & Trotman, 1992) at p. 130 (point 4–014) apparently take the view that activities begun after the close of the preceding financial year must be taken into account.

13. It might be added that if Davies & Newman Holding, Dan Air's parent-company, had separated the charter activities and the non-charter activities into independent subsidiaries and if BA thereupon had acquired only the activities and liabilities relating to the non-charter activities the case would appear to fall squarely within Art. 5(2). Likewise if BA had acquired both the charter and non-charter activities from Davies & Newman Holding and thereupon had closed down the charter activities it seems equally clear that the case would fall outside Art. 5(2).

4.4 *Consequences of the Court's interpretation*

It has been noted above that Article 5(2) was introduced as an exception to the main rule in Article 5(1), so that insignificant concentrations should not be caught by the Regulation where the parties to the transaction are large undertakings. It has furthermore been noted that Article 5(2) opened a possibility of circumvention and that Article 5(2)(2) therefore introduces a provision to prevent such circumvention.

The question is whether the Court's ruling in the *Dan Air* case has not opened new possibilities of circumventing the Regulation.

The Merger Control Regulation has a very favourable reputation amongst lawyers in the Community. The fact that the Regulation has provided a system of exclusivity between the Member State competition authorities and the Commission has meant that competition lawyers are frequently advising clients to adapt a transaction so that it falls within the scope of the Regulation where the transaction would otherwise have to be vetted by a national competition authority which is more likely to reach an adverse finding (typically the German *Bundeskartellamt*). Correspondingly, where falling within the scope of the Regulation is likely to produce more problems than falling outside the Regulation, transactions may be adapted accordingly. Whether or not this kind of forum shopping is good or bad remains an open question.[14]

The Court's ruling in the *Dan Air* case seems to open the possibility of "tailoring" a concentration so that it falls within or outside the Regulation.

Example I:
Undertaking A has an evenly spread Community-wide turnover of ECU 4.5 billion. A has no sales outside the Community. A acquires the ailing undertaking B which has a turnover of ECU 530 million all of which is derived in the Community. A intends to close down activities of B which derive a turnover of ECU 50 million.

14. See in this regard for instance the discussion between Juenger and Opeskin: Juenger, "What's Wrong with Forum Shopping?" 16 *Sydney Law Review* (1994), 5–13; Opeskin, "The Price of Forum Shopping: A Reply to Professor Juenger", 16 *Sydney Law Review*, 14–27; and Juenger "Forum Shopping: A Rejoinder", 16 *Sydney Law Review*, 28–31.

If the acquisition contract contains an irrevocable condition that B must close down the ECU 50 million activities before the final transfer of the activities then the ECU 5 billion threshold has not been met and the concentration falls outside the scope of the Regulation. In contrast to this, where the contract does not include such an irrevocable condition the concentration will have a Community dimension.

Example II:
Undertaking A, with an evenly spread Community-wide turnover of more than ECU 5 billion, acquires undertaking B with a Community-wide turnover of ECU 260 million. Undertaking A intends to close down activities in B which generate ECU 20 million in the Community.

If the acquisition contract contains an irrevocable condition that B must close down the ECU 20 million activities before the final transfer then the ECU 250 million threshold has not been met with regard to B and the concentration will not have a Community dimension. On the other hand, if A chooses to effect the needed closure itself after the transfer, the concentration will have a Community dimension and will be notifiable with the Commission.

Example III:
Undertaking A, with a Community-wide turnover of more than ECU 5 billion and with more than two thirds of this turnover derived in Germany, acquires undertaking B. B has a Community-wide turnover of ECU 915 million of which ECU 600 million is derived in Germany. A intends to close down activities in B which generate ECU 20 million in the Community but outside Germany.

If the acquisition contract contains the same irrevocable condition as in example II, both A and B will achieve more than two-thirds of their Community-wide turnover in Germany and the concentration will be outside the scope of the Regulation. If A decides to carry out itself the intended reduction after the acquisition of B the concentration will have a Community dimension and fall within the jurisdiction of the Commission.

These are only three examples. It is, however, possible to build on these examples and thereby show a plethora of situations in which the

Dan Air case has opened new and interesting ways of forum shopping.

The examples show that according to the *Dan Air* rule what is crucial is the time of the closure of the activities. If the closure is made before the acquisition the result will differ from the situation where the closure is effected after the acquisition. What is important is that from an economic viewpoint, identical situations will or will not have a Community dimension depending on the chronological order in which the take-over and the closure are made.

On this basis it is respectfully submitted that the *Dan Air* rule seems to blur the Community dimension rule and at the same time it does not adequately take economic realities into account.

4.5 *Final remarks*

The consequences flowing from the *Dan Air* case have been recognized by the Commission. In the eyes of the Commission, the main problem created by the ruling is not so much that it conflicts with the basic scheme of the Regulation but rather that it has opened a possibility of circumvention. Therefore the Commission has issued guidelines in which it provides a very restrictive interpretation of the *Dan Air* ruling. Hence in accordance with the Court's judgment the Commission states that "if a company disposes of a subsidiary or closes a factory at any time before the signature of the final agreement or the announcement of the public bid or the acquisition of a controlling interest bringing about a concentration, or where such divestment or closure is a precondition for the operation the turnover generated by that subsidiary or factory must be subtracted from the turnover of the notifying party as shown in its last audited accounts."[15]

What is important is that the Commission employs the term "disposes" where the Court explicitly employed the terms "transfer" and "discontinuance". Since a disposal is a much more drastic step than a

15. Para 27 of the Commission Notice on calculation of turnover, *supra* note 7. Indeed the Commission in a footnote to para 27 makes an explicit reference to the *Dan Air* case.

mere discontinuance this clearly reflects the Commission's intention to narrow the scope of the *Dan Air* rule.

However, the Commission goes on to explain that:

> "Other factors that may affect turnover on a temporary basis such as a decrease of the orders of the product or a slow-down of the production process within the period prior to the transaction will be ignored for the purposes of calculating turnover. No adjustment to the definitive accounts will be made to incorporate them."[16]

It is obvious that the latter interpretation is not founded on the Court's ruling in the *Dan Air* case. Nevertheless, it seems that this interpretation re-establishes some of the structure and logic which the notion of Community dimension was intended to provide and it is therefore submitted that the Commission has managed to get the best out of an awkward situation.

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16. Para 28 of the Commission Notice on calculation of turnover, *supra* note 7.

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