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McCARTHY REPORT

Possible Sale of Irish Commercial Ports

Following the recent publication of the Report of the Review Group on State Assets and Liabilities (the "McCarthy Report"), it is expected that a number of commercial ports in Ireland will be offered for sale by the Irish Government at some stage in the future, following the Review Group's recommendation that privatisation of some or all of the ports should be considered.

Review Group on State Assets and Liabilities

In view of the levels of indebtedness of the Irish State, the Minister for Finance established a Review Group on State Assets and Liabilities in July 2010 to examine and provide advice on the proper stewardship of certain State assets and on opportunities for the better use of those assets. In carrying out its analysis over a number of months, the Review Group consulted with the relevant Government departments and State bodies that have oversight of the applicable assets, including commercial semi-state companies and regulators. It also invited submissions from interested third parties by way of public consultation.

The members of the Review Group are economist Colm McCarthy (Chairman) of University College Dublin, Donal McNally, Second Secretary in the Department of Finance and economist Prof. Alan Matthews of Trinity College Dublin. The Review Group published its final report on 20 April 2011.

Terms of Reference

The following terms of reference were set for the Review Group:

- To consider the potential for asset disposals in the public sector, including commercial State bodies, in view of the indebtedness of the State;
- To draw up a list of possible asset disposals;
- To assess how the use and disposition of such assets can best help restore growth and contribute to national investment priorities; and
- To review where appropriate, relevant investment and financing plans, commercial practices and regulatory requirements affecting the use of such assets in the national interest.

Possible Sale of Commercial Port Operations

The list of commercial State bodies reviewed by the Group included the

following port authorities: Dublin Port Company, Port of Cork Company, Drogheda Port Company, Galway Harbour Company, Port of Waterford Company, Shannon Foynes Port Company, Wicklow Port Company, New Ross Port Company, Dundalk Port Company and Dún Laoghaire Harbour Company (the "**Port Companies**"). The Port Companies are commercial limited liability companies owned by the State through the Minister for Finance and the Minister for Transport. The commercial port of Rosslare was also examined by the Review Group. It is also a State operated port, but its ownership structure is slightly different in that it is part of the CIE Group.

Regulation of Ports in Ireland

The Port Companies included in the list of commercial State bodies reviewed by the Group were established under, and are regulated by, the Harbours Acts 1996 to 2009 (the "**Harbours Acts**"). The Port Companies are statutorily responsible for the management, control, operation and development of certain harbours. They also have the power to make bye-laws with respect to the use of, and the safe navigation within, their respective harbours and generally with respect to the regulation of the harbour and the property of the Port Company concerned. The Port Companies also have as their objects the provision of facilities, services, accommodation and lands for ships, goods and passengers, the promotion of investment and the management, control, operation and development of the approach channels to the harbour. For example, Dublin Port Company describes itself as "a self-financing, private limited company wholly-owned by the State, whose business is to manage Dublin Port, Ireland's premier port. Established as a corporate entity in 1997, Dublin Port Company is responsible for the management, control, operation and development of the port. Dublin Port Company provides world-class facilities, services, accommodation and lands in the harbour for ships, goods and passengers. The company currently employs 144 staff."

As incorporated bodies, the Port Companies are obliged to comply with the Companies Acts 1963 to 2009 as they apply to companies limited by shares in Ireland, including in relation to the keeping of accounts and the filing of annual returns and audited accounts with the Companies Registration Office. In addition, the Port Companies have obligations under the Harbours Acts to provide to the Minister for Transport on an annual basis, audited profit and loss accounts, cash flow statements and balancing sheets, as well as any other audited accounts as the Minister may from time to time direct that the Port Companies are required to maintain. Each of the Port Companies is also obliged under the Harbours Acts to submit an annual report to the Minister of its activities and those of its subsidiaries during that year. Copies of the



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audited accounts and the annual reports are laid before the Oireachtas by the Minister.

Recommendations of the Review Group

The Review Group made two recommendations as regards the Port Companies:

- That the State-owned ports, including Rosslare, should be restructured into several competing multi-port companies, built around Dublin, Cork and Shannon-Foynes, and that the Competition Authority should be involved in this process.
- That the privatisation of some or all of the ports should be considered, ideally after the recommended restructuring. The Review Group further recommended that the adequacy of competition in the sector on an all-Ireland basis should be reviewed prior to the privatisation and suitable regulatory arrangements instituted if deemed necessary.

Acquisition of a Port Company – Legal Issues for a Potential Buyer to Consider

If, based on the Report of the Review Group, the Government offers for sale one or more of the Port Companies, a significant investment opportunity in Ireland will arise. As an island State, commercial ports are of considerable importance for trade and commerce. The Review Group stated in its Report that “the seaport sector in Ireland handles over 95% of Ireland’s external trade by volume”.

As part of a due diligence process in the acquisition of a Port Company, a potential purchaser would have a wide range of legal issues to consider in relation to the target company, including the following:

Contracts

It is likely that each of the Port Companies has a large number of commercial contracts in place with operators at the ports concerned, for example with container ship companies, passenger ferry businesses, and stevedore operators providing Lift-on/Lift-off (lo-lo) and Roll-on/Roll-off (ro-ro) services. All such contracts would need to be carefully reviewed at the due diligence phase of the acquisition process.

Employment and Pensions

With regard to employees, in our experience there are particular labour issues which are likely to arise in the context of the disposal of a port interest because of unusual customs and practices and collective agreements. Understanding these issues and potential liabilities would be key for any potential purchaser at the due diligence phase of the acquisition process. Planning for change and implementing organisational restructuring post-transfer within this highly unionised environment requires a clear understanding of the risks and parameters for negotiating such changes. A potential purchaser will need to be aware of the industrial relations issues that are likely to arise.

With regard to pensions, in our experience the terms of the pension schemes of the Port Companies can be complex. The pension schemes and their funding will need to be examined in detail by any purchaser in order to establish any potential liabilities connected to them.

Property

The Port Companies have the power to acquire and dispose of land and would be expected to have significant property interests at the ports in question. In some cases development lands may have been purchased by the Port Companies. Complex property arrangements are often in place at ports in relation to oil pipelines, for example. Such issues would need to be examined by a potential purchaser. Sales of property by Port Companies would be conducted by way of lease, usually adopting a standard



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format, and any assignments of such leases would be subject to the Port Companies' consents. Purchasers would be required to comply with the Port Companies' regulations, including those relating to environmental and fire safety compliance.

Indebtedness

Subject to Ministerial consent being granted, the Port Companies have a statutory right to borrow money. Therefore, a potential purchaser needs to be aware of any charges or encumbrances that may have been created against Port Company property and/or assets and registered against the Port Company concerned, for example with the Property Registration Authority and/or the Companies Registration Office.

Competition

Any potential purchaser of a Port Company with existing port or related interests is likely to face competition issues. Irish competition law requires a merger or acquisition to be notified to, and approved by, the Irish Competition Authority if certain given thresholds are met. The relevant thresholds are as follows:

- the worldwide turnover of each of two or more of the "undertakings involved" in the merger or acquisition is not less than €40m. The expression "undertakings involved" in an acquisition is taken to mean the target (and its subsidiaries) and the purchaser (and its group); and
- the turnover in the Republic of Ireland of any one of the undertakings involved in the merger or acquisition is not less than €40m; and
- two or more of the undertakings involved in the acquisition carry on business in any part of the island of Ireland (Northern Ireland and the Republic of Ireland).

Even if the above criteria for a compulsory notification are not met, competition issues may still arise as the general competition rules have been held to apply to a merger or acquisition which does not meet the thresholds for compulsory notification but gives rise to a substantial lessening of competition in the market. If the potential purchaser is engaged in overlapping activities due to its existing port interests or existing presence on related upstream or downstream markets, a voluntary notification may well need to be submitted to the Competition Authority to avoid competition risk. It may be that a bank providing finance stipulates as a pre-condition to drawdown under its acquisition facility that the proposed transaction is cleared by the Irish Competition Authority. Any notification to the Irish Competition Authority will require detailed submissions on various competition law aspects of the transaction including the relevant product and geographic markets and most likely will require the submission of an economic analysis supporting the contentions that the proposed transaction will not give rise to a substantial lessening of competition which may include for example arguments that the relevant geographic market is the island of Ireland (as ports throughout the island compete for business), rather than solely the port concerned by the acquisition. Voluntary notifications are required to be accompanied by an independent economist's report.

It should be noted that all notifications to the Irish Competition Authority are published on the Authority's website and significantly third parties are invited to make submissions within 10 days of the publication. With respect to the acquisition of port interests, it is our experience that it is likely that third parties will object and therefore it is important for the notifying parties at the outset to have their competition arguments well thought out and developed in anticipation of adverse submissions from third parties.

The Irish Competition Authority recently conducted a merger review of the proposed acquisition by Stena AB, through its subsidiary Stena Line (UK) Limited, of vessels, related assets, inventory, employees and contracts relating to passenger and freight ferry services operated by DFDS A/S



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between Belfast and Heysham and between Belfast and Liverpool. The above transaction was cleared by the Competition Authority on 7 April 2011 after conducting a full four month Phase 2 investigation. The Authority expressed competition concerns at the end of its initial one month Phase 1 review and decided to launch a full Phase 2 merger review. The Authority only conducts such in depth merger reviews in the most difficult of merger cases and indeed this was one of only two such Phase 2 merger reviews carried out by the Authority in the last 12 months. The Authority as part of its review contacted competitors and customers of the parties (The UK Competition Commission is continuing with its investigation and is expected to report by 25 July 2011). The parties had initially proceeded to complete the transaction prior to clearance by the Authority which resulted in the Authority issuing a press statement warning against gun jumping and confirming that the transaction was void until approved by the Authority. The above case highlights the need for significant competition law preparation in any such case.

LK Shields Solicitors' Experience

LK Shields Solicitors has a reputation as one of the Ireland's leading experts in mergers and acquisitions having acted in the acquisition and disposal of many high profile companies and businesses. We have significant experience in dealing with the highly complex issues specifically arising on the sale and purchase of a Port Company, including the contractual, property, employment, pensions and competition issues that may be involved. We are consistently ranked among the top Irish legal firms in the field of mergers and acquisitions.

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About LK Shields Solicitors

LK Shields Solicitors is one of the leading law firms in Ireland. Founded in 1988, we have consistently grown and we now have upwards of 130 staff. We enjoy and take pride in our work and offer clear commercial advice to our clients. We ably meet the full legal services needs of both international and national businesses across a large range of industry and service sectors.

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