BUSINESS ACQUISITIONS AND MERGERS
FROM THE POINT OF VIEW OF COMPETITION LAW

Concept of Concentration

(Article 3 Regulation 139/2004 EC)

Concentration: mean a change of control in an undertaking or a change in the quality of control on a lasting basis resulting from:

- merger of previously independent firms or parts of
- acquisition of direct / indirect control of an undertaking or part of
- a "full function joint venture":
    - a jv performing on a lasting basis all the functions of an autonomous economic entity

Control: the possibility to exercise ***decisive influence*** on an undertaking, arising out of:

- shareholding + voting rights
- minority shareholding with special - preferred rights
- minority shareholding where increased majority is required
- veto rights arising from shareholding agreements
- acquisition of property rights and assets
- economic dependence
- a minority shareholding when the remainder of shares are widely dispread (de facto control)

- an <u>option</u> right entitling a party to acquire shares in a company in the future
- <u>management agreements</u>
- having the <u>majority of directors</u> in a BoD

Control can be - de jure control - de facto control

Control can be - sole control - joint control

Control can be - negative control (which is usually joint as well): in case of veto rights

Decisive influence: making or blocking strategic decisions

Merger: means <u>legal</u> merger in the strict sense, i.e.

- <u>amalgamation</u> of more legal entities that cease to exist as separate legal entities in a single business unit
- when one undertaking completely <u>absorbs</u> another that cease to exist as a separate legal entity

Sole control: - a single entity exercises decisive influence on a firm

- this is usually expressed <u>positively</u>, i.e. the ability to determine strategic decisions
- de jure or de facto

Joint control: - two or more entities exercise decisive influence on a firm

- this is usually expressed <u>negatively</u>, i.e. the ability to block strategic decisions
- where there are two shareholders on a <u>50%/50</u>% basis and hence need to reach a common understanding in order to avoid deadlock situation

- where there are two major shareholders that need to cooperate in order to overcome objections by other minority shareholders who could block decision making otherwise
- de jure or de facto

Change to the quality of control:

- when a shareholder substantially increases its participation,
- change from joint control to sole control and vice versa,
- change in joint control by amending shareholding participations due to i.e. entrance of new shareholder, replacement of existing shareholder by another,
- reduction of the number of controlling shareholders, etc.

JOINT VENTURES

If a jv is a full function jv it qualifies as a concentration and falls under Reg. 139/2004; otherwise is it an agreement falling under Art. 101 (1).

In many respects, it is beneficial to fall within the scope of Reg. 139/2004 because:

- prior notification and authorization is possible which provides legal certainty,
- it may benefit from single filing, if it has Community dimension,
- the competitive assessment under Reg. 139/2004 is less onerous under the Reg. since the criterion is "not to significantly impede competition", while under Art. 101(1) the criterion is "agreements that have as their object or effect to restrict competition"

A jv falls under Reg. 139/2004 only if it is a "full function", has on a lasting basis all the functions of an autonomous economic entity.

<u>Full function:</u>

Autonomous and independent

Operating on a lasting basis and destined to operate on a lasting basis

Its own independent management

Its own sufficient resources:

- assets
- finance
- employees
- clientele

When it is NOT full function:

- if it simply undertakes one specific function of its parents (i.e. usually a R&D jv)

- if it is only a joint sales agency purchasing from its parents and adding little value to the goods or services concerned
- it merely holds (for tax or other reasons) real estate property for its parents
- it could not survive operationally and financially but only save for transactions with its parents (save that it can rely on its parents for an initial start-up period of up to three (3) years)

Lasting basis:
- it is a lasting jv if its parents have allocated to it adequate resources that allows it to be lasting
- it can be for a definite period of time, provided that this is long enough to affect the structure of the market; if it is for a short period it will not be lasting,
- a dissolution of the jv clause in case of disagreement or failure of the jv project does not render the jv to be a non-lasting one
- it is not lasting if the jv is set up to complete a specific task which does not require a long time, like to complete the construction of a plant without being involved in its operation afterwards
- it is not a lasting one if commencement of its operations is conditioned on an approval, or a license, or any third party decision, which is not a mere formality but is of essence; in such cases it is unclear whether the jv will ever become operational at all

<u>Enlargement</u>

In case the parents decide to enlarge the scope of the jv during its lifetime, such enlargement may qualify as a separate and distinct concentration, particularly if it entails the acquisition of another undertaking

<u>JV that are not concentrations:</u> these are Art. 101 (1) agreements such as R&D agreements, production and specialization agreements,

commercialization, standardization, etc. Some of these may be block exempted agreements.

<u>Coordination of competitive behavior</u>

The initial Reg, included a negative clause that a jv that had as its object or effect the coordination of competitive behavior of undertakings which remained independent could not qualify as a full function jv.

The negative condition has now been removed as a jurisdictional criterion

However, it remains to be decisive for the substantial appraisal.

MERGER CONTROL

PURPOSE OF MERGER CONTROL

The purpose of merger control is to enable competition authorities to <u>regulate changes in market structure</u>.

Mergers cause more lasting and more serious changes in the market than agreements, which are regulated under Art. 101(1).

Mergers may have advantages and disadvantages; the purpose of merger control is to prohibit those mergers where disadvantages outweigh advantages.

Disadvantages of mergers

Identifying potential disadvantages of mergers is crucial, because it provides an answer to the policy question "when and why mergers should be prohibited" and "when and why should a competition authority interfere with mergers", i.e. what is the justification for merger control. Should only competition considerations be taken into account, or should other wider factors be taken into account, such as unemployment, social policy, regional policy, etc.

Moreover, another controversial issue is whether identifying an adverse effect on competition should be final and fatal for the conclusion of the merger (i.e. because it leads to market power), or whether other consideration should also be taken into account, such as:

(a) the merger may lead to greater efficiencies that outweigh the detrimental effects,
(b) the merger may save a falling firm which could not make it otherwise,
(c) there are other valid industrial, social, or other policy consideration.

1. Market power & dominance. For merging firms, market power and dominance may be the object (the true motive) of a merger. Even if it is not its object, it may be its effect. Mergers may lead to increase of market power, or even an oligopolistic market structure, i.e. increased prices, less research, lower quality of products, etc. So, mergers damage the competitive structure of the market.

- Horizontal mergers. They have more direct effects on the market than vertical and conglomerate mergers. In particular, in the after merger market:
  (a) there is one competitor less
  (b) the after merger firm has a larger market share

  Oligopolistic interdependence effect and parallel behavior. These are more likely to occur after a merger in a market that lacks competitiveness.

  Concentration – Coordination – Unilateral effects. Even if a merger does not lead to dominance and oligopoly, it usually leads to greater concentration. Concentration makes coordination easier, so coordinated effects are more probable. Concentration also diminishes the uncertainty which is innate to competition and hence makes more probable unilateral effects. All these may result to increased prices and other distortions of competition. It is a controversial issue whether the Commission or national competition authorities should interfere with a merger in a market that is only concentrated.

- Vertical mergers:

(a) the main fear about vertical mergers is that if the parties involved have market power at any vertical level, their merging may have foreclosure effects

(b) they may increase price transparency

(c) they may facilitate collusion

- Conglomerate mergers

Conglomerate mergers are those that have no horizontal or vertical effects; as such they have in principle no competition concerns. They are usually motivated by the desire to expand in another market, or to reduce risk.

The fear about conglomerate mergers is that:

(a) if the post-merger company has market power in one market, it may use it to foreclose competition in a neighboring market, i.e., tying, etc.

(b) conglomerate mergers may lead to loss of potential competition, i.e. if the merging firms operate in the same product market but at different geographic markets, or if the merging firms operate in neighboring markets; i.e. merging firms would otherwise compete.

2. Big firms are a threat to individual freedom and competition as such. According to one view, one of the targets of competition law is to protect individual freedom and competition as such. From this point of view mergers are in principle suspect.

3. Too big to fail. One of the aftermaths of the recent crisis is that firms should not be allowed to become too big, so that it is difficult to allow then to fail and have to be rescued. Competition law and merger control should be used to prevent firms becoming too big to fail.

4. National interest for sensitive sectors. For sectors like media (plurality), national defense, etc. there are national interests not to allow oversees control.

5. Unemployment. Mergers, and rationalization of production that usually follows, may result to loss of jobs.

Advantages of mergers

Economies of scale. Mergers may result in economies of scale in terms of production, distribution, research, costs, etc.; hence a merger may lead to more rapid and more cheap development that through internal growth.

Economies of scope. A larger product scope.

Failing firms and unemployment. A merger may save a failing firm and prevent unemployment.

Entry into oligopolistic market. Entry by merger in an oligopolistic market may make this market more competitive.

Optimum allocation of capital assets. By allowing transfer of businesses capital assets are allocated in the best possible way and business enterprises end up to those who will maximize their productivity and return; this is to the benefit of social welfare as well.

Liquidation of business investment. Merging is a way to liquidate an investment in a business; if mergers were not allowed, entrepreneurs would be unwilling to invest in businesses. Every business investment looks forward to a profitable divestment probably by way of a merger. No one would be willing to set up a business, if he could not sell it (No barriers to exit).

Single market integration. Cross border mergers may enhance single market integration.

National champions. Mergers may result to larger companies and create national champions that will be able to be more competitive in the international level.

EUROPEAN MERGER CONTROL

Historical process to an EU merger control Regulation

The ECSC Treaty contained a merger control provision.

The EEC Treaty did not.

Mergers were more decisive in the field of coal and steel and possibly the EEC by that time favored concentration and the creation of large firms to achieve economic expansion.

The Commission first acknowledged that some merger control was necessary in 1966 in a Memorandum on Concentration of Enterprises in the Common Market. In 1973 it produced its first Draft Regulation on merger control. Adoption of a Regulation required unanimous decision by the Council and views on the matter were divergent among member states. The two central issues were:

(a) Jurisdiction. When and on what conditions control should be passed by the member states to the Commission and what the relationship among national and EU law would be.

(b) Appraisal criteria. Should factors other than competition factors be taken into consideration?

Art. 102 - CONTINENTAL CAN

In the absence of a Merger Control Regulation the Commission used Art. 102 as a means for merger control. This view was adopted by the Court also. In the case of CONTINENTAL CAN the Court agreed with the Commission that Art. 102 is infringed if a firm with a dominant position uses its dominance to acquire another firm and to reinforce its dominance in a way that competition is substantially restricted. By that time the threshold required for dominance was relatively low; so Art. 102 was a useful means. However, certain cases escaped the application of Art. 102, such as the case were two non-dominant firms were merging to form a dominant one, or were a non-dominant firm was acquiring a dominant one.

Art. 101 (1)

The initial approach of the Commission was that Art. 101(1) was inappropriate to deal with mergers, mainly because many types of mergers did not qualify as *agreements*, particularly hostile take overs.

Later on, however, the Commission and the Court, reasoned that Art. 101(1) might apply to the acquisition of a minority shareholding in a company (BAT & REYNOLDS). This judgment raised many difficulties and ambiguities and was used by the Commission as a weapon to push member states to agree to the adoption of a merger control regulation. After this judgment member states gave green light for a new draft merger control regulation following the 1973 proposal of the Commission. The current EUMR deals with mergers on an exclusive basis, that is Art. 101 and 102 are inapplicable.

Arts. 101 and 102 can be applied, though, by national courts and national competition authorities when the EUMR does not apply.

Market pressure

During the '80s the European economy has gone through an increasing number of mergers, which made it clear that merger control was necessary.

The industry also became more supportive to a proposed EU merger control system, in order to avoid multi filing in many member states in case of mergers with effects in many countries.

Reg. 4064/1989 was the first Reg. on merger control + procedural Reg. and Commission Notices.

Green Paper 1996: proposed amendments like:

(a) a lower jurisdictional threshold, as many EU significant mergers escaped the scope of application of the Reg.,

(b) new rules on joint ventures

(c) rules on concentrations of credit institutions

Reg. 1310/1997: amended Reg. 4064/89 and introduced the Green Paper amendments. + procedural regulation and Commission Notices.

Green Paper 2001: proposed radical amendments on several issues like:

- how to deal with mergers which have no Community dimension, but require multiple filing,
- making referral of merger cases among the Commission and national competition authorities more flexible,
- revision of the "dominance" substantive test,
- revision of time frames

Reg. 139/2004: adopted the above proposed amendments + procedural regulation + Commission Notices

Review 2008: consultation and report to the Council on 2009; the jurisdictional mechanism with the threshold and the corrective jurisdictional mechanism were found to be appropriate although further improvement was possible.

Recently the Commission proposed that even mergers involving acquisition of a minority shareholding might raise competition concern, particularly potential competition issues, as companies acquiring minority participation to one another may not be willing to compete.

HORIZONTAL MERGERS

Non Coordinated Effects

Unilateral effects mean that the merger will result to elimination of completion, i.e. to removal of competitive restraints.

Factors:

Large market shares. The post merge entity will have a large market share, particularly if this is going to be substantially larger than the next competitor's.

No demand substitutability. Customers of the post merge entity will have limited possibility to switch to other suppliers.

No increase in output. Competitors are unlikely to increase output if the post merge entity increases prices.

Prevent expansion. The post merge entity is able to prevent expansion of competitors, i.e. in case the merged entity holds patents or other crucial IP rights.

Significant competitor. Maverick. The merger will remove from the market a significant competitors, a very innovative firm, a very aggressive competitor, a competitor who is likely to distort coordination.

Coordinated effects

Oligopolistic interdependence. Collective dominance.

Airtours three factors for collective dominance as in other notes.

Factors:

Merger with a potential competitor

There are anti-competitive effects particularly if the entity absorbed possesses assets that make entry into market easier and with limited sunk costs.

Two factors must exist:

(a) The potential competitor must already exercise significant competitive pressure

(b) Absence of other potential competitors making equal pressure.

VERTICAL & CONGLOMERATE MERGERS

The following apply to both vertical and conglomerate mergers.

Benefits from vertical and conglomerate mergers

Vertical and conglomerate mergers are less likely to cause anti-competitive effects.

They do not engage the risk to eliminate direct competition as the parties involved are not direct competitors.

They also result to substantive efficiencies such as:

- "Internalization of double mark-ups": integration of complementary activities leads to "internalization of double mark-ups", which means that an integrated firm that improves productivity in one level will enjoy benefits not only at this level, but at upstream and downstream levels as well, and hence has an increased incentive to seek for such improvement.
- Integration decreases transaction costs.
- Integration increases internal coordination at several levels, such as product design, production, sales, etc.
- One stop shopping benefit for customers: integrated firms can offer a range of products usually sold to the same set of customers and this gives customers the benefit of one stop shopping.

- Integration aligns the incentives of the parties acting downstream and upstream to invest in new products, advertising, etc.; i.e., distributors have incentive to invest in R&D, advertising, etc.

Anti-competitive concerns of vertical and conglomerate mergers

Vertical and conglomerate mergers do not raise anti-competitive effects, unless the post-merge entity has significant market power (not necessarily dominance) in at least one relevant market.

It is effects of the merger on customers that matter; it is not effects on competitors as such that are of concern. The mere fact that a merger may harm competitors because it creates efficiencies is not by itself an anti-competitive concern (GE/Honeywell – Tetra Laval / Sidel)

The main concerns are:

- **Non coordinated effects**
  Foreclosure
- **Coordinated effects**
  Structural changes make coordination more likely

Market Shares – Market Concentration

In vertical mergers only post-merge market shares and market concentration are examined.

There are concerns if there is market power in at least one market.

Vertical and conglomerate mergers are unlikely to cause concerns if the following thresholds are not exceeded:

- 30% market share of the post-merge entity at any relevant market,
- post-merge HHI below 2.000

Even if these thresholds are exceeded, there is no presumption of anti-competitive effects.

Even if these thresholds are not exceeded, there may be anti-competitive concerns, however, in case of the following:

- elimination of a significant competitive force: the merger involves a firm that is likely to expand significantly in the future, i.e. due to an innovation,
- there are significant cross-shareholdings, or cross-directorships among competitors,
- one of the merged firms is a firm with high likelihood of disrupting coordination
- there are indications of past or present coordination.

VERTICAL MERGERS

NON COORDINATED EFFECTS - foreclosure

Non coordinated effects consist in **foreclosure** of actual or potential competitors.

Foreclosure includes both absolute foreclosure, as well as the case where competitors are discouraged from competing more actively, or are disadvantaged and hence compete less effectively.

Another non coordinated effect of vertical mergers is that the merged entity may gain access to commercially sensitive **information** of its competitors in the upstream, or downstream markets.

Types of foreclosure

Input foreclosure

Downstream competitors are restricted access to an important input.

The merged entity is likely to be unwilling to supply competitors as it would do absent the merger. Competitors' costs will increase. The merged entity may have the opportunity to increase its prices and still retain profitability.

The following are examined:

- Ability to foreclose
- Incentive to foreclose
- Whether foreclosure would have a significant impact

Customer foreclosure

Upstream competitors are restricted access to a sufficient customer base, i.e., when a supplier merges with an important customer.

Again the following are examined:

- Ability to foreclose
- Incentive to foreclose
- Whether foreclosure would have a significant impact

COORDINATED EFFECTS

With respect to coordinated effects, the same principles apply as in horizontal mergers. What is specific to vertical mergers is that:

Vertical integration may render coordination most likely because it may increase certain parallel behavior facilitating factors such as:

- may increase market transparency,
- through foreclosure it may limit the number of competitors
- may increases symmetry
- may eliminate a competitor disrupting coordination (a "maverick")

In more details:

Input foreclosure

- **Ability to foreclose**

The following factors are helpful to access ability to foreclose:

- Market power of the merged entity
- Oligopolistic structure of the input market
- Other suppliers absence or inefficiency
- Important input: whether there is an important input, i.e. which is a critical cost factor, or a critical component, so that restricted access to it is decisive.

- **Incentive to foreclose**

Incentive to foreclose may depend on the following:

- Profitability of foreclosure; you need to compare upstream market profitability and downstream market profitability; there is incentive if profitability downstream is greater than upstream,

- Profit margins upstream and downstream, there is incentive if profit margins are greater downstream,
- Likelihood of gaining market share in the downstream market; there is incentive if there is a strong likelihood to gain market share downstream,
- Downstream market share; the larger the downstream market share, the greater the expected profit from foreclosure will be,

An upstream monopolist would not have incentive to foreclose competitors in the upstream market, because due to its monopoly he is already able to extract great profits upstream.

➢ **Impact of foreclosure**

The level of impact of foreclosure depends on the following:

- Level of price increases downstream; the greater price increases are downstream, the greater the impact is – price increases downstream are likely to be high if:
    - Costs for downstream competitors are substantially increased,
    - Foreclosed competitors are sufficiently important
- Potential competition is sufficiently foreclosed

Foreclosure may be countervailed by:

- Downstream buying power,
- Upstream potential competition

EFFICIENCIES

The same efficiencies apply as in horizontal mergers.

Efficiencies specific to vertical mergers are:

- "Internalization of double mark-ups"
- Integration decreases transaction costs.
- Integration increases internal coordination at several levels, such as product design, production, sales, etc.
- One stop shopping benefit for customers.

- Integration aligns downstream and upstream parties incentives.

Customer foreclosure

- **Ability to foreclose**

  Chances that there is ability to foreclose are higher when:

  - there are no alternative customers downstream
  - the merger involves a significant customer with market power
  - economies of scale or scope in the input market; because in such cases competitors' costs are likely to increase,
  - demand has network effects (i.e. the value of a product for a customer increases when the number of other customers using it increases),

- **Incentive to foreclose**
  - It depends on profitability

- **Impact of foreclosure**
  - It depends on the proportion of output that is affected

CASES

AOL / TIME WARNER

Time Warner was a media company and AOL an internet service provider. AOL had entered into an agreement with a leading EU music industry, Bertelsmann. The proposed merger would result to a post-merger integrated company that could distribute Time Warner content (music, films and news) through AOL internet distribution network. AOL had already gained access to a particularly strong music content through its agreement with Bertelsmann and now through its merger with Time Warner would gain access to the latter's music content as well.

There were concerns that AOL would dominate the emerging internet market particularly in the field of internet music content delivery.

The merger was cleared after AOL provided commitments to sever its links with Bertelsmann.

Johnson & Johnson (JJ) / PFIZER

The proposed concentration related to the acquisition by JJ of Pfizer's consumer health care sector, including nicotine replacement therapy and products business.

JJ was itself active in the nicotine replacement therapy and products retail market. In this market it main competitor was GlaxoSmithKlein (GSK). GSK was purchasing nicotine replacement products from Pfizer.

There were concerns that JJ would post-merge attempt to foreclose GSK from effective access to nicotine replacement products.

NOKIA / NAVTEQ

Nokia is the mobile telephones manufacturer. It proposed to purchase the shares of Navteq, a digital maps database provider. Digital maps databases are an essential input in navigation applications installed in mobile telephones. There were only two digital maps databases providers, Navteq and Tele Atlas. So, this was a vertical merger.

There were concerns that vertical integration could restrict competition in the digital maps databases market. Analysis proved that there was neither ability to foreclose competitors (because there was another efficient provider, Tele Atlas), nor incentive to do so, because such a foreclosure would not be profitable.

TomTom / TELE ATLAS

TomTom is a navigation software and navigation devices manufacturer. Tele Atlas is one of the two digital maps databases providers. Digital maps databases are used in navigation software and devices. TomTom proposed to purchase the shares of Tele Atlas. So, this was a vertical concentration. In addition, other mobile phones manufacturers would not be prevented as well.

There were concerns regarding TomTom foreclosing its competitors from input access to digital maps databases. Analysis proved that there was neither ability to do so (due to another efficient provider, Navteq) nor incentive because such a foreclosure would not be profitable, i.e. lost sales from digital maps databases would not be compensated by increased sales of mobile phones.

CONGLOMERATE MERGERS

Conglomerate mergers are those between firms that are in a relationship which is neither purely horizontal (as competitors in the same relevant market) nor vertical (as suppliers and customers). In practice, the focus is on mergers between companies that are active in closely related markets (i.e. mergers involving suppliers of complementary products or of products which belong to a range of goods that is generally purchased by the same set of customers for the same end use).

In principle conglomerate mergers do not raise competition concerns, save in specific cases only.

Anti-competitive and pro-competitive effects are taken into account and balanced.

Non coordinated effects

The main concern is **foreclosure** of competitors.

Foreclosure may result due to the combination of products.

Combination of products may allow the merged entity to strengthen its position in one of the related markets by using (through tying and bundling, or other exclusionary practices – linking together sales of products in the separate markets) its strong market position in the other.

- **Ability to foreclose**

Ability to foreclose by way of bundling, tying, etc. depends on, which, if present, make foreclosure easier:

- Market power (but not necessarily dominance) in one of the markets
- The characteristics of the products which sometimes make bundling and tying more possible, i.e. when products are designed to work together,
- Absence of alternative resources of supply

- Differentiated products (→ no alternative resources of supply)
- Complementary products, because in such cases there is usually a large common pool of customers who tend to purchase both products together and this makes bundling and tying more easy,
- Economies of scale in the relevant market
- Network effects in the relevant market

➢ **Incentive to foreclose**

Incentive to foreclose depends on profitability of bundling and tying, i.e. profit margins and turnover in each of the related markets.

➢ **Impact of foreclosure**

There is impact particularly if:

- a large portion of output is affected,
- there are any significant rivals in the market.

Countervailing powers limiting impact are:

- buying power
- potential competition by newcomers

EFFICIENCIES

The efficiencies of vertical mergers apply also to conglomerate, like the “one stop shop effect” and the “internalization of double mark ups”.

Specific to conglomerate mergers are the following:

- economies of scope resulting to costs reduction
- benefits to consumers such as:
    - better compatibility of products
    - increased quality assurance

Coordinated effects

These involve the concern that parallel behavior becomes more possible.

Conglomerate mergers may make parallel behavior more possible by eliminating the number of competitors.

CASES on Vertical and Conglomerate mergers

GENERAL ELECTRIC / HONNEYWELL INTERNATIONALLY

(a Commission and General Court and ECJ case)

The proposed concentration was the acquisition of Honeywell be GE.

GE was dominant in the large commercial aircrafts and regional aircrafts jet engines market.

Honeywell was the leading producer of avionics (aviation electric systems), non-avionics and corporate jet engines.

The concern was that GE's dominant position in the large commercial aircrafts and regional aircrafts jet engines market would be reinforced further and that GE would become dominant in the avionics, non-avionics and corporate jet engines market as well. In particular the main concern was that GE would leverage its market power by engaging in bundling and strategic price cuts, thus foreclosing competitors. It was thought that the proposed concentration would result in price cuts in the short terms, but that these would be followed by price increases in the long term. On this ground the Commission prevented the concentration, although it was cleared in the US.

The Commission's reasoning that short term price cuts would be followed by price increases in the long term was heavily criticized as a speculative one. Price increases would follow if other competitors could not match the efficiencies achieved by the proposed merger. However, merger control is destined to protect competition (i.e. customers) not competitors. So, it was proposed that short term efficiencies should not be sacrificed by the Commission in the hope of maintaining competition in the long term.

The General Court confirmed the Commission's decision, but only in respect to its horizontal effects (i.e. the large and regional commercial aircraft jet engines market) where the proposed concentration would result to a monopoly.

In respect to conglomerate effects (i.e. foreclosure and anticipated price increases), the General Court found that the Commission's decision was not substantiated and that there was no adequate evidence of either ability to foreclose or incentive to foreclose.

The concentration also affected the marine turbines market, as well. Objections were raised to a merger among a company producing marine gas turbines and another producing the controls and components used in those turbines. The concern was that due to bundling there could be foreclosure effects.

The same merger was found to create a monopoly in other markets (aircraft turbines) and was prevented on that basis.

The ECJ reversed the General Courts decision on another purely legal issue: The General Court had reasoned that in assessing ability and incentive to foreclose, one should also take into account that such a practice would be illegitimate under Art. 102 and hence the legal risk of violating Art. 102, and the risk of being detected and fined for this should also be taken into consideration. The ECJ reversed the GC judgment on this point.

AXALTO GEMPLUS (a Commission case)

Objections were raised against a merger among a company producing SIM cards for mobile devices and a company producing an operating system for SIM cards. The concern was that there could be foreclosure effects, because the post-merge entity would be able to set compatibility standards that would prevent the development of alternative products.

TETRA LAVAL / SIDEL

This case related to a proposed concentration by the acquisition of Sidel by Tetra.

Tetra was dominant in the market for liquid food cartons and respective machinery.

Sidel was leading in the market of liquid food plastic bottles machinery.

Liquid food cartons and plastic bottles were considered to be substitutes.

The Commission found that there could be horizontal, vertical and conglomerate effects. In particular, it considered that:

- Tetra's dominant position in the cartons market would be further reinforced and that
- Tetra would leverage this dominant position in the plastic bottles machinery market.

The General Court and the ECJ both reversed the Commission's decision, on the ground that ability and incentive to foreclose were not adequately substantiated by the evidence.

The main issue raised by both Honeywell and Tetra Laval is about the standard of proof required for a future analysis. This is an issue problematic by itself.

<u>GOOGLE / DOUBLE CLICK</u>

Google was leader in search advertising and online advertising market and Double Click was leader in the ad serving market.

The Commission considered chances of foreclosure, but found them unlikely.

<u>GUINESS / GRAND METROPOLITAN</u>

This was a "portfolio power" case.

The concentration related to the spirits market.

As a result of the concentration the post-merger entity would possess a very wide portfolio of spirit brands and this was considered to lead by itself to the strengthening of the dominant position it already possessed in certain spirits. On this ground the Commission prevented the merger.

The decision is criticized on the ground that widening brands portfolio leads to efficiencies of scale and scope and that this is usually to the benefit of consumers and effective competition.

The decision could be better substantiated if portfolio power was invoked as an indication of possible ability and incentive to be engaged in bundling and tying.

<u>NESTLE / GERBER</u>

A brands portfolio power case.

The Commission cleared the proposed merger.

The Commission raised a distinction between:

- a pure portfolio power effect
- a strategic use of portfolio power combined with financial power

A pure portfolio power effect is not by itself anti-competitive, as it is only an incentive for customers to purchase a wide range of products from the same source and it is only an "one stop shop" efficiency.

A strategic use of portfolio power in combination with financial power would mean practices such as bundling and tying, strategic price cuts, targeted discounts and discriminatory promotions; this would be an anti-competitive foreclosure practice. In this case the Commission found no such ability and incentive.

on would be significantly impeded in the common market should be declared compatible with the common market; and any concentration that created or strengthen dominant position should be declared incompatible.

Green Paper 2001 – SLC test

Substantial Lessening of Competition

The Green Paper discussed the SLC test which was applied in the US and other jurisdictions, but was not supported by the Commission.

Arguments in favor of the SLC test

Procedural arguments:

International convergence. It would lead to greater international convergence, since it was applied in the US and other jurisdictions.

Substantive arguments:

Concentrated markets. Collective dominance. Unilateral effects. SLC was proposed to be more broad and more appropriate to catch mergers in already concentrated markets, which would escape the dominance test. This is so in particular with regard to mergers resulting to collective dominance and unilateral effects. The US "Baby Food merger" was proposed as an example in favor of the SLC test. In the US Gerber had the 65% of baby food market, while Heinz and Milton together had a 33% Heinz and Milton proposed to merge. The merger did not result to either creating or strengthening a dominant position, but is was lessening competition, as Heinz and Milton competed very hard to be the number 2 supplier in super markets as well as in terms of innovation and product differentiation. In the US the merger was banned for lessening competition and leading to parallel behavior. It was proposed that in the EU it could not be prohibited on the basis of the dominance test. In general, this was a concern about all types of mergers were the number 2 and 3 competitors merged, while the number 1 retained a large market share. The UK and Ireland favored the SLC test, but Germany and the Commission favored the dominance test.

Arguments against the SLC test

Uncertainty. Switching to a new test in the EU would cause uncertainty.

Inconsistency with member states. Most member states already applied the dominance test having adopted the EU model.

Substantive arguments. The gap of the dominance test was a hypothetical and not a real one.

The New EUMR – rephrasing & reorganization – SIEC test

Since a unanimous decision of the member states was required to amend the old EUMR, a compromise was achieved, through a rephrasing and reorganization of the dominance test as stated in the respective article of the EUMR.

Art. 2(3) of the New EUMR provides that a concentration that would significantly impede effective competition, particularly as a result of creating or strengthening a dominant position would be declared incompatible with the common market. This is the SIEC test. Horizontal Merger Guidelines provided adequate guidance.

Broader. The SIEC test is broader than the dominance test. It catches all mergers leading to unilateral effects in a concentrated market, even in the absence of dominance or collective dominance.

Dominance retained. Still creating or strengthening dominance continues to be a decisive banning factor under the SIEC test and hence the previous decisional practice and jurisprudence is preserved.

Advantages of the SIEC test. It is more appropriate for concentrated oligopolistic markets. It is more appropriate for unilateral effects. It encompasses the advantages of the SLC test.

Joint ventures

In addition to the SIEC test, supplementary criteria are set by art. 2 (3), (4) and (5) for joint ventures.

A j.v. is a concentration if it is a full function enterprise on a lasting basis. If it is it is assessed on the basis of the SIEV test.

However, if the object or effect of the j.v. is the coordination of competitive behavior of undertakings that remain independent, such coordination is assessed according to Art. 101 (1), (3) of TFEU. In this respect the Commission takes into account:

- if the parents retain activities in the same market as the j.v. or an upstream or downstream or neighboring market,
- if the coordination resulting from the j.v. allows the parties involved to eliminate competition

(cases of j.v. coordination were: TELIA/TELENOR/SCHIBSTED, FUJITSU/SIEMENS, BT/AT&T;

In these cases the methodology of the Commission was to determine:

- if the object of the j.v. was the coordination of the parents,
- if coordination could be the effect of the j.v.
- whether there are upstream, downstream, or neighboring markets were cooperation through a j.v. could result to coordination.

Burden of proof

The burden of proof is in the Commission.

However, there is no presumption that a concentration is either compatible, or incompatible with the common market.

The standard of proof is the balance of probabilities.

A comparison should be made as to what the situation may be if the concentration takes place and if it does not.

A causal link between the merger and the competitive harm has to be established.

Although the Commission is regarded to have discretion on the assessment of economic aspects, the General Court will thoroughly examine whether the evidence and the analysis produced by the Commission is correct, reliable, adequate and properly substantiated (TETRA LAVAL).

SUBSTANTIVE APPRAISAL OF MERGERS

(Art. 2)

SIEC test: "not significantly impedes effective competition"

Art. 2(2)

"A concentration which would not significantly impede effective competition in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared compatible with the common market".

This is the SIEC test. SIEC= significantly impedes effective competition.

The SIEC test means that one has to consider the post-merger:

- Unilateral effects (non-coordinated effects)
  elimination of competition in the absence of any coordination
- Coordinated effects
  parallel behavior effects, dominance

Factors to be taken into account

Art. 2(1)

- need to maintain effective competition
- market structure
- actual competition
- potential competition
- market shares of parties involved
- market power of parties involved
- alternative sources of supply
- barriers to entry, including legal barriers
- supply and demand trends
- consumers interests
- technical and economic progress, provided it is to consumers benefit and does not form an obstacle to competition

Joint Venture for the coordination of competitive behavior

Art. 2(4)

If the concentration consists in a joint venture *(necessarily a full function enterprise, for otherwise it will not qualify as a concentration and it will not fall within the scope of Reg. 139/2004; instead it will fall directly within Art. 101(1))* which has as its object or effect the coordination of the competitive behavior of undertakings that remain independent, then such coordination shall be appraised under Art. 101(1).

Factors to be taken into account:

- whether parent companies retain activities in the same market as the jv, or a downstream, or upstream, or neighboring market
- whether coordination allows the parties involved to eliminate competition

Future ("would have") effects analysis

The appraisal is based on a future events (a "would have") effects analysis. Because of this the approach as to dominance is different in Art. 102 and the Reg.

Market definition

The relevant market has to be determined.

The same criteria are used as in Art. 101 cases.

However the analysis in merger cases is a "future oriented" one; hence, past demand trends and past demand substitutability is less important than future demand trends and future demand substitutability.

Dominant position

Creation or strengthening of a dominant position is one of the cases where effective competition is impeded.

Dominant position:

"An undertaking enjoys dominant position if it is amble to prevent effective competition and has the market power to behave independently of its competitors, customers and consumers"

(UNITED BRANDS, HOFFMANN-LA ROCHE)

It is possible that a merger may result to ***making dominant a third party***.

In the case of GRUPO VILLAR/EnBW/HIDROELECTRICA the proposed merger would result to strengthening the position of two other undertakings in the Spanish energy market, because after the proposed merger one of the parties to the merger would not have any interest to export energy to Spain. The merger was allowed only on the basis of commitments that the above would not happen.

Single dominance: a single firm enjoys by itself a dominant position.

Factors taken into account to assess dominance in merger cases:

- market shares of parties involved post-merger
- market shares of other competitors
- stability of market
- existence of purchasing power or other countervailing power
- other commercial strengths, i.e.:
    - superior technology
    - ip rights
    - vertical integration

Collective dominance: when market power is concentrated in the hands of only a few market participants (an oligopoly) and evidence indicates tacit coordination of market behavior by members of an oligopoly in the long term.

(AIRTOURS, BMG/SONY/IMPALA)

In Airtours and BMG/Sony/Impala the Court set three factors that are taken into account in order to assess likelihood of collective dominance. These are repeated in the Horizontal Mergers Guidelines in connection to the appreciation of the so called "coordinated effects", that is parallel behavior:

Whether competitors (members of an oligopoly) will be able post-merger to monitor whether the coordination is adhered to

Market transparency

There must be sufficient market transparency so that each member of the oligopoly to be aware of how the other members market behavior is evolving.

Each member of the oligopoly must be able to understand that interdependence is profitable to all.

Each member of the oligopoly must be able to confirm that other members are adopting the same common policy and are maintaining it – able to trace any deviations.

Whether there is a deterrents / incentives mechanism to secure adherence to the coordination for a long time

Sufficiently long term period of coordination

Tacit coordination (parallel behavior) must be sustainable over a long time.

There must be incentive not to depart from the common policy, or there must be deterrents preventing deviations.

Whether the foreseeable reaction of the outsiders (competitors, consumers) would jeopardize coordination

To prove collective dominance the Commission must establish that the foreseeable reaction of current and future competitors and consumers would not jeopardize the results expected from the common policy.

Active collusion is not necessary; silent coordination is sufficient.

For the purposes of merger control, collective dominance is established even in the absence of any provable contacts among undertakings; it is sufficient that the proposed merger will lead to a market structure which would make parallel behavior possible.

Market shares

According to the Commission, a market is affected due to a concentration, if certain market share thresholds are exceeded. These thresholds are:

(a) Horizontal relationships: combined market share exceeding 20%

(b) Vertical relationships: combined market share exceeding 30%

(c) Where the combined market share is between 20%-50% but the increase in market share as a result of the merger is small, the simplified procedure is again followed.

If these thresholds are not exceeded the concentration is regarded to raise no competition concerns and is examined under the simplified procedure.

If thresholds are exceeded, this does NOT mean that the merger is likely to impede effective competition and there is no presumption to this effect.

According to the new implementing Regulation 1269/1913 (replacing Reg. 802/2004) other markets to which a concentration may have a significant effect are:

(a) markets where any of the parties to the concentration has a share exceeding 30% and any other party is a competitor,

(b) markets where any of the parties to the concentration has a share exceeding 30% and any other party holds important IP rights

(c) neighboring markets where the combined market share of the parties in any of the neighboring markets is 30% or more; neighboring markets are closely related markets, i.e. markets of products that are complementary, or products that belong to the same range of goods that are generally purchased by the same set of customers for the same end use.

HORIZONTAL MERGERS – HORIZONTAL EFFECTS

There are horizontal effects only when the parties involved are actual or potential competitors in the same relevant market; if not the effects may be only vertical or conglomerate.

The assessment process is as follows:

- market definition
- market shares
- market concentration
- anti-competitive effects
  - unilateral (non-coordinated) effects
  - coordinated effects
- countervailing buying power
- potential competition / barriers to entry
- efficiencies from merger
- failing firm argument

Market shares - Dominance

Market shares

More than 40 – 50 %

Up to 25%

The AKZO case established a presumption that a market share of 50% or more may be evidence of dominant position.

The Commission has found in many cases that mergers involving a combined market share of 40% impeded competition.

If the combined market share does not exceed 25%, competition is most probably not impeded.

Market concentration

Delta up to 250 in concentrated markets (HHI: 1.000 – 2.000)

Delta up to 150 in highly concentrated markets (HHI: 2000 - ...)

Herfindahl – Hirschmann Index (HHI)

A measure of market concentration.

Ranges from 0 – 10.000.

0 – 1.000 market not concentrated

1.000 – 2.000 market concentrated

2.000 – 10.000 market highly concentrated

The rate of pre and post-merger concentration is examined (Delta).

The Commission applies the following Delta thresholds:

Concentrated markets: 250 point

Highly concentrated markets: 150 points

The increase in the rate of concentration should not exceed these thresholds.

Anti-competitive effects

Horizontal mergers cause two main concerns:

- ***non-coordinated effects (unilateral effects)***

The merger may result to an elimination of competition, i.e. to reduce competitive pressure, even in the absence of any coordination.

This is more likely in oligopolies, but it is possible on non-oligopolistic markets as well.

Factors that may indicate a likelihood of non-coordinated (unilateral) effects are:

- merging firms have large market shares, particularly if there is a great difference from the next post-merge competitor' s share (GE / INSTRUMENTARIUM: 2 of the 4 leading competitors proposed to merge – MCI Worldcom / Sprint)
- merging firms are close competitors, particularly if their products are differentiated, because in such a case their respective products are likely to be close substitutes and hence there will be less substitutability with the products of other competitors
- close substitutability of the products of the merged firms is a concern, because customers will not have any alternative resources of supply post-merge (VOLVO / SCANIA)

- merging firms customers have limited possibilities to switch to another supplier (Boeing / McDonnel Douglas , Volvo / Scania , Ryanair / Air Lingus)
- competitors of merging firms are not likely to increase their output, if the post-merger entity increases prices, i.e. other competitors cannot efficiently compete. If other competitors are not likely to increase their output, then the merged entities are likely to restrict output themselves and hence cause an increase of prices (MCI / Sprint)
- post-merger entity could prevent the expansion of competitors (BaByliss: where the merged entity would posses a unique portfolio of brands, while its competitors would posses single brand only – MCI / SPRINT – GE / INSTRUMENTARIUM)
- merger will eliminate an important competitive force, i.e. when one of the merging firms is an important player in the market (T-MOBILE AUSTRIA: the 2nd and 4th leading competitors proposed to merge, but the 4th was a significant one who would be eliminated – BOEING / McDONNELL DOUGLAS)

CASES

T-MOBILE AUSTRIA was an unilateral effects case

T-MOBILE merger would leave the market with two major firms, one far smaller than the two and another one which was very small. In addition one of merging firms was particularly strong in the retail market and was an important competitive force which would be absorbed by the other merging firm (one of the two big players).

EDF / SN AIRHOLDING

The Commission found that the proposed merger would result to remove EDF as a significant potential new entrant in the relevant market (wholesale electricity market in Belgium). After the merger

EDF would have a limited incentive to develop new generation capacity plants in Belgium. EDF offered commitments to remove these concerns and the merger was allowed.

BOEING / McDONNEL DOUGLAS

Customers of the merged entity would have only limited access to alternative suppliers. – Products differentiated. Products were close substitutes (similar cases VOLVO / SCANIA and RYANAIR / AIR LINGUS)

BaByliss:

The post-merge entity would possess a unique portfolio of brands, while its competitors would possess single brands only.

- ***Coordinated effects (parallel behavior)***

The merger is likely to cause structural changes in the market to render it an oligopoly where parallel behavior becomes more likely.

Market factors facilitating coordination:

- oligopolistic structure
- homogeneous product
- stability of supply / demand trends
- absence of innovation
- market transparency
- firms with similar costs structures, similar market shares, similar output capacity, other similarities, etc.

The Guidelines identify three factors to be taken into account:

- (i) Whether competitors (members of an oligopoly) will be able post-merger to monitor whether the coordination is adhered to / Market transparency
- (ii) Whether there are deterrents / incentives mechanism to secure adherence to the coordination for a long time

- (iii) Whether the foreseeable reaction of the outsiders (competitors, consumers) would jeopardize coordination (AIRTOURS , BMG/SONY/IMPALA)

Other dominance cases are:

Teva / Barr (pharmaceuticals)

Zanofi-Aventis / Zentiva (Pharmaceuticals)

Lufthansa / SN Airholding (airlines); the proposed merger would lead to a monopoly in certain airline routes. Commitments were offered making the entry of new competitors likely and the merger was cleared.

Countervailing buying power

If there is strong buying power anti-competitive effects by be prevented from arising.

There is buying power when there are alternative sources of supply.

Switching to alternative sources of supply must be possible immediately and without additional costs.

Buying power usually comes from large and sophisticated customers.

Such buying power should exist for all customers and not only for a part of them.

Potential competition – Barriers to entry

Entry of newcomers to the affected relevant market is a countervailing factor when it is:

- likely
- timely
- sufficient to deter or defeat any potential anti-competitive effects

➢ Likelihood of entry

Entry is likely when it is sufficiently profitable

- i.e., in a market with *high growth*, rather than in a declining market

Entry is not likely when:

- it involves high risks and high costs, particularly high sunk costs
- viability requires large market shares
- there are scale economies or network effects in the market
- prices are already depressed
- there are barriers to entry, such as
    - legal berries to entry
    - incumbent firms enjoy technical advantages, intellectual property rights, access to essential facilities or natural resources
    - brand loyalty, and in general the incumbent firms hold a well-established position in the market

➢ Timeliness of entry

It is taken into account if it occurs within 2 years

Timeliness greatly depends on the characteristics of the market

➢ Sufficiency

Entry must be of sufficient scope and magnitude to deter or defeat any anti-competitive effects

Efficiencies of merger

Several efficiencies may be associated to concentrations such as:

- Dynamic competition effects, i.e. increasing competitiveness,
- Economies of scale.
- Economies of scope.
- Innovation and technological advance in case of R&D jv

- Entry into oligopolistic market.
- Cost savings leading to lower prices
- Optimum allocation of assets.
- Single market integration.

Merger efficiencies are taken into account according to Art. 2(1).

Efficiencies must be likely to enhance the ability and the incentive of the merged entity to act pro-competitively for the benefit of consumers.

Efficiencies must:

- benefit consumers
- be merger specific
- be verifiable

➢ Benefit to consumers

Efficiencies

- must benefit consumers in those relevant markets where competition concerns arise
- must be substantial
- must be timely

Cost savings

- qualify as efficiencies if they result to lower prices
- this is more likely in connection to reduction of variable and marginal costs than fixed costs
- cost savings resulting from anti-competitive reduction of output are not taken into account

Innovation, new products, R&D jv

- this is a characteristic efficiency

Coordinated effects – Efficiencies

The risk of coordinated effects may be outweighed if efficiencies increase the merged entity's incentive or ability to act pro-competitively, i.e. to increase output and decrease prices – this is usually happening with efficiencies in innovation

Timeliness

Efficiencies expected at a later stage in time will not be taken into account

Competitive structure of the market

It is more probable that the merged entity will pass efficiencies to consumers if the market structure is a competitive one, i.e. if the remaining firms make an adequate competitive pressure.

On the contrary, it is highly unlikely that a concentration leading to a monopoly would be declared compatible to the common market due to efficiencies (except where the falling firm defense applies – OLYMPIC / AEGEAN).

- Merger specific

  Efficiencies must:

  - be the direct result of the concentration
  - cannot be achieved with less anti-competitive alternatives

- Verifiability

  Efficiencies must be verifiable and if reasonably possible, quantifiable.

  Efficiencies expected at a later stage in time are not likely to be taken into account.

Failing firm defense

(KALI & SALZ)

(OLYMPIC & AEGEAN)

An otherwise problematic merger may be declared compatible with the common market, if one of the merging firms is a falling one which will soon be forced out of the market.

In such a case the deterioration to the market structure is inevitable and is not due to the merger.

Factors to be considered:

- the falling firm would be forced out of the market soon due to financial difficulties,
- there is no less anti-competitive alternative purchase than the merger in question,
- in the absence of the merger, the assets of the falling firm would exit the market.

FAILING FIRM DEFENCE

US law

The defense originates in US merger control law and is mentioned in the 1992 US Horizontal Merger Guidelines.

Historically, it was developed to protect creditors, owners and employees; so it was not oriented towards competition efficiencies, but it was inspired from distributive justice.

There are competition efficiencies when the following are balanced:

- Bankruptcy administration costs
- Monopoly created due to failing firm forced out of the market by itself
- Benefits from keeping assets of failing firm in production
- Social costs

So under US law the pre-requisites are:

1. Failing firm unable to meet financial obligations in the near future
2. Failing firm unable to reorganize successfully

3. No alternative less anti-competitive offers that would keep assets in the production
4. Assets would exit production

EUMR

The failing firm defense is discussed in the Horizontal Merger Guidelines.

KALI & SALZ

Merger with failing firm would result to a monopoly.

Deterioration of market structure (exit of assets from production) is not due to the merger, so it is not the mergers that SIEC. If market deterioration is not the cause of the merger, the merger must be declared compatible with the common market.

Pre-requisites:

1. Acquired undertaking will be forced out of the market
2. Acquiring undertaking will inevitably acquire the market share of the failing firm, as there are no other competitors in the market
3. There are no less anti-competitive offers, although tenders had been invited

BASF (Commission's decision)

What is material is that the deterioration of the market structure is not the cause of the merger.

So, it is not necessary to establish that the acquiring firm would inevitably acquire the market share of the failing firm. – it suffices to establish that assets will exit production.

AEGEAN/OLYMPIC

Aegean was the only competitor of Olympic.

Olympic would exit the market

There were no other alternative less anti-competitive offers.

Market deterioration was not due to the merger itself.

SHELL/NYNAS

Shell's oil refineries in Hamburg were a failing firm and NYNAS proposed to acquire them.

All pre-requisites of the failing firm defense were in place, plus:

- If Shell's refineries were closed, the ***volume of production would decrease and this would lead to price increases***
- Efficiencies evolved because the proposed merge would lead to ***reduction of variable costs*** that could be passed to consumers through ***lower prices***