How close is too close?

Dealing with closeness of competition in merger control proceedings

2017
1. What is closeness of competition and how is this assessed in practice?

2. How does closeness of competition fit into the assessment of horizontal mergers?

3. How is closeness of competition assessed in key jurisdictions outside the EU?

4. What can merging parties do to prepare themselves to deal with closeness of competition issues on live transactions?
Company A (60% market share) wishes to acquire Company B (10% market share)

- combined market share of 70%

- Turnover of A and B satisfies the filing thresholds under the EUMR

- What is the likelihood of getting the merger cleared by the EC?
EUMR entered into force in 1990 – since then there has been an exponential growth in the number of notifications
Evolution of merger control in the EU

- Amended EUMR entered into force in 2004:
  - "Dominance" test replaced by "SIEC" test:
    - Does the merger result in a significant impediment to effective competition?
  - Does move to SIEC test represent a shift in EC's approach?
- Today: closeness of competition = key factor in horizontal mergers (e.g. FedEx/TNT, Siemens/Dresser Rand)
  - EC more willing to adopt a fact-reliant approach to assess horizontal mergers: recognition that mergers between 'distant competitors' may not have any negative impact on competition
Merger control – Other jurisdictions

Jurisdictions where there is a merger control regime

N.B. Voluntary regimes include Australia, Bolivia, Chile, Hong Kong, New Zealand, Panama, Singapore, UK and Venezuela
Closeness of competition – key points to remember

- Closeness of competition arguments are **not** a panacea for horizontal mergers resulting in high combined market shares
  - All depends on the right facts!
- Horizontal mergers resulting in low combined market shares may now be looked at as potentially problematic
  - E.g. Novartis/Hexal, Hutchison 3G Austria/Orange Austria, UPS/TNT
What is closeness of competition?

- It describes the relationship between two merging companies' products:
  - If as a result of a price increase, customers of Company A are more likely to switch purchases to Company B (than another player), then Companies A and B = 'close' competitors
  - 'Close' does **not** mean 'closest'

- Why does this matter?
  - Economists assume that, post-merger, the merged Company AB will likely raise prices significantly (even where A and B are not each other's closest competitor)

- Factors indicating closeness of competition:
  - Similar product portfolios and price points, shared customers etc.
Assessment of horizontal mergers

- **In the EU:**
  - Objective of EU merger control: identify those mergers likely to have a negative impact on competition (e.g. higher prices for consumers)
  - Market shares = initial filter BUT EC will look at a range of factors, including closeness of competition

- **Outside the EU:**
  - Many other jurisdictions adopt similar approach: e.g. Australia, Brazil, China, Germany, the US etc.
  - Importance of market shares for assessment varies:
    - Germany: market share analysis alone not decisive
    - US: DOJ/FTC increasingly moving away from market share analysis and degree of closeness a key factor for the assessment
Assessing closeness of competition – Parties' own documents and data

- **Aim:** understand whether parties' combined market share is a good indicator of their competitive constraint

- **Sources of information:**
  - Win/loss data from tenders
    - Do the parties frequently participate in the same bids?
    - Do the parties have less chance of winning a bid when facing each other in a bid?
  - Internal documents → can be decisive for outcome of a merger!
  - Information on parties' product portfolios and marketing strategies
  - Parties' customer lists
  - Price data
Assessing closeness of competition – 3rd party data and documents

- Research/industry reports
- Data on customer preferences and switching patterns
  - What happens when Competitor A raises prices and loses market share → do customers go to Competitor B or another market player?
- Survey data
  - EC increasingly relies on survey data in merger control proceedings → often runs its own customer and/or competitor surveys
Examples of relevant data and information

- US IRS data
- Information on customer demographics and purchasing behaviour
- Shop size and location
- Revenues by product category
- Feedback from industry associations, downstream customers as well as competitors
- Physical characteristics of the goods
- Brand strength
Some examples from the European Commission's recent enforcement practice

<table>
<thead>
<tr>
<th>Case</th>
<th>Combined Market shares</th>
<th>Closeness of competition analysis</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amadeus/Navitaire [2016]</td>
<td>Up to 60-70%</td>
<td>EC considered the parties to be distant competitors.</td>
<td>Unconditional Phase I clearance</td>
</tr>
<tr>
<td>Siemens/Dresser Rand [2015]</td>
<td>Up to 50-60%</td>
<td>EC considered the parties were not close competitors.</td>
<td>Unconditional Phase II clearance</td>
</tr>
<tr>
<td>Hutchison 3G Austria/Orange Austria [2012]</td>
<td>&lt;25%</td>
<td>EC considered the parties close competitors &amp; stated that their market power was higher than market shares suggested</td>
<td>Conditional Phase II clearance</td>
</tr>
<tr>
<td>Kraft/Cadbury [2010]</td>
<td>60-70%</td>
<td>EC considered that the parties were close competitors in Poland and Romania (leading to divestments in these countries) but not in UK and Ireland.</td>
<td>Conditional Phase I clearance</td>
</tr>
<tr>
<td>Novartis/Hexal [2005]</td>
<td>35-40% with a 0-5% increment</td>
<td>EC considered Novartis' leading branded OTC rheumatics product Voltaren and Hexal's competing Diclac product close competitors</td>
<td>Conditional Phase I clearance</td>
</tr>
</tbody>
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Case Study – Kraft/Cadbury

- Both parties were strong players in chocolate confectionary business in Europe
- Significant (60-70pc) combined market shares in Ireland, Poland, Romania and the UK
  - UK and Ireland: small increment, detailed econometric analysis → parties not close competitors
  - Poland and Romania: market investigation, no detailed econometric analysis → close competitors, Kraft agreed to divest parts of Cadbury in both countries
Experience from other jurisdictions

US:
- 2010 DOJ/FTC Horizontal Merger Guidelines signalled a clear shift away from market share analysis
- Key to identify likelihood of post-merger price increases → closeness of competition seen as central factor

Germany: FCO is embracing a more economic approach → when the facts are right it's worth exploring bringing arguments on closeness of competition
- Edeka/Tengelmann merger: first prohibition decision based solely on SIEC test following in-depth closeness of competition assessment

Australia:
- Guidelines of the ACCC expressly refer to closeness of competition as one of the factors to be taken into account
- Arguments on closeness of competition can turn cases around – e.g. clearance of 4:3 merger in JB Hi-Fi and The Good Guys

China: Closeness of competition is taken into account BUT market share analysis remains key element of assessment

Brazil: CADE's current guidelines are clearly mirrored on the DOJ/FTC guidelines BUT looking at closeness of competition is a recent development for CADE
Dealing with closeness of competition on live transactions

- Early discussions with legal advisers are key!
- Market share analysis = starting point
- If combined market share >30% and increment >5% \(\rightarrow\) assess scope for running closeness of competition arguments:
  - What data is available?
  - What do the parties' internal documents say about their competitive relationship?
  - If initial analysis points towards a certain degree of closeness or is inconclusive consider hiring external economists.
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