How close is too close?

Dealing with closeness of competition in merger control proceedings

2017

Agenda

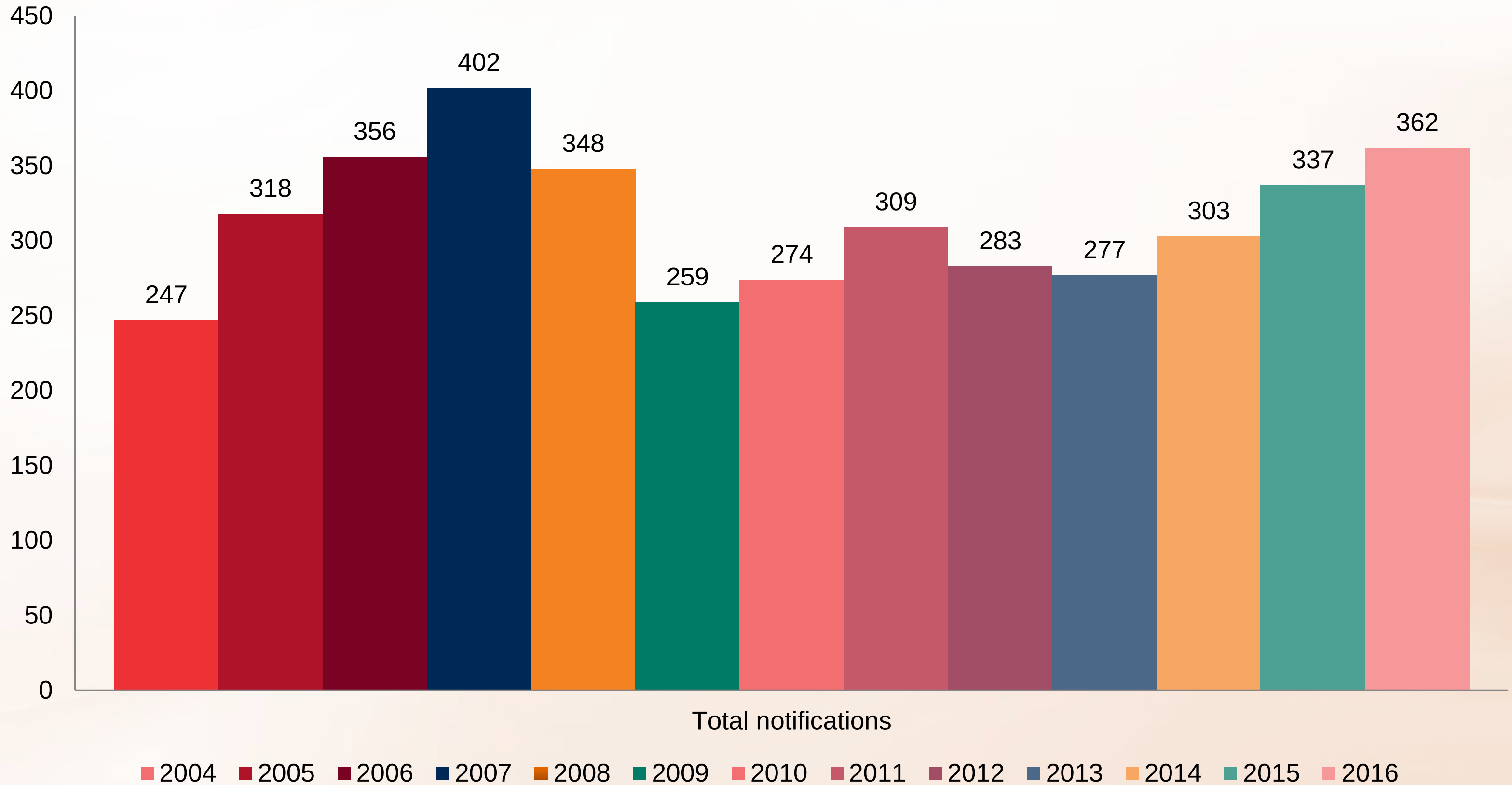
1	What is closeness of competition and how is this assessed in practice?
2	How does closeness of competition fit into the assessment of horizontal mergers?
3	How is closeness of competition assessed in key jurisdictions outside the EU?
4	What can merging parties do to prepare themselves to deal with closeness of competition issues on live transactions?

Setting the scene …

- 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?

Evolution of merger control in the EU

- EUMR entered into force in 1990 – since then there has been an exponential growth in the number of notifications



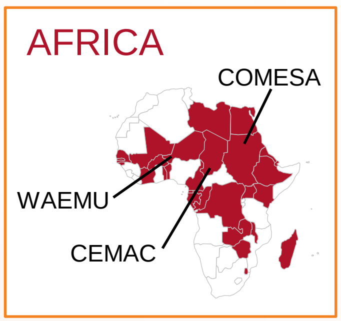
Evolution of merger control in the EU

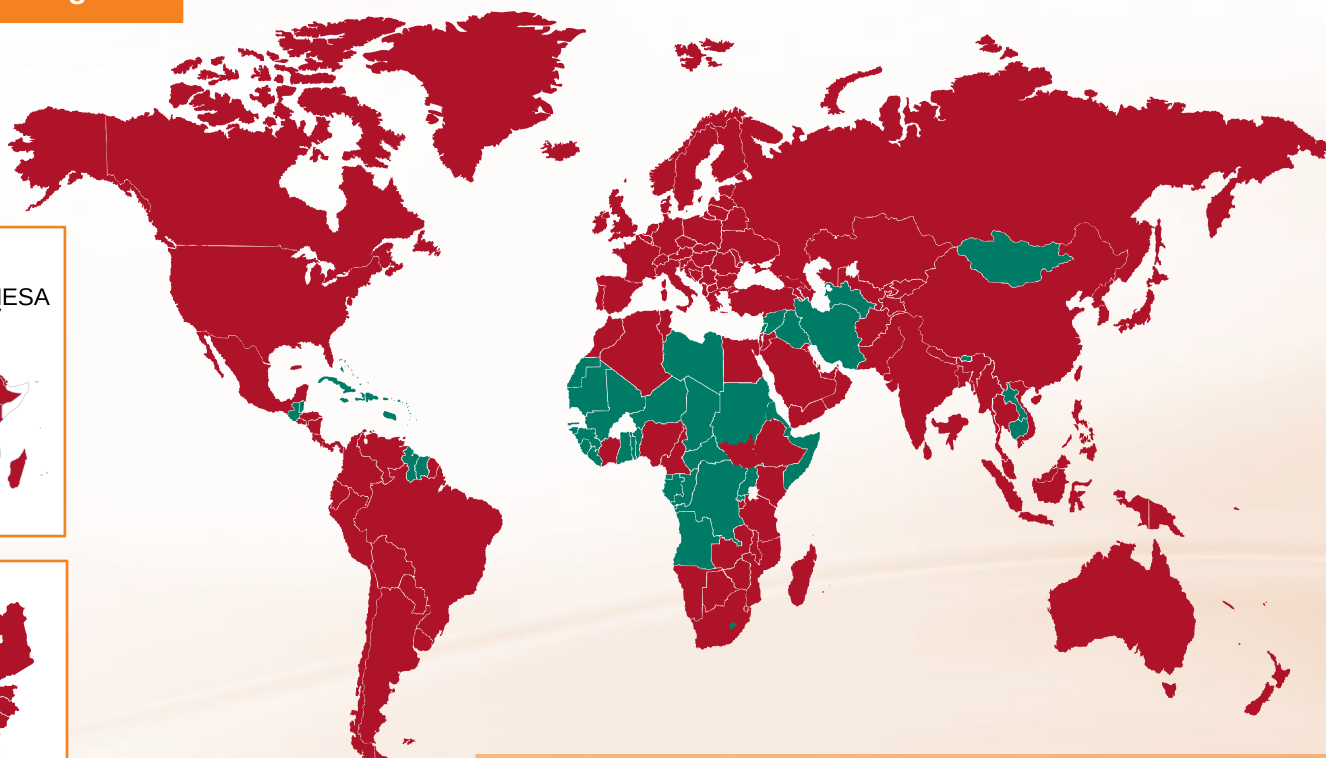
- Amended EUMR entered into force in 2004:
  - "Dominance" test replaced by "SIEC" test:
    - Does the merger result in a significant impediment to effective competition?
  - Does move to SIEC test represent a shift in EC's approach?
- Today: closeness of competition = key factor in horizontal mergers (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

Global Spread of **Merger Control**

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

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

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 Gudelines 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% → 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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