ALLEN & OVERY

BIICL 9th Annual Merger Conference, 18 March 2011

Hot Topics

Outline

- Coordinated effects
- Minority stakes
- Market definition
- De minimis and materiality
- Non-horizontal enforcement
- Counterfactual

Coordinated Effects: Transatlantic Perspectives

Why So Few Cases?
Is the U.S. Going 'Pre-*Airtours*'?
Are Cases Being Missed?

Coordinated effects: post-*Airtours* enforcement

- **EU**
  - Since *Airtours*, EU cartel enforcement has gone into overdrive
  - And there has been 1 merger enforcement case in 8 years purely on coordinated effects
  - And then, it was a late-breaking theory of harm
  - *ABF/GBI* – a 3:2 in yeast in Spain/Portugal
  - Phase II divestment remedy including plant to new competitor
- **UK**
  - Since *Airtours*, UK cartel enforcement has gone into drive
  - And there as been 1 merger enforcement case in 8 years based on coordinated effects
  - And then, the theory was only raised at CRM and required a new issues meeting
  - OFT Phase I remedy in *Aggregate Ind./Foster Yeoman* (asphalt)
  - Merger puts duopolists AI and Lafarge into same JV, remedy to divest AI stake in JV
  - Several cases cleared by the CC: 4:3 in bricks, 4:3 in sugar, 6:5 in cartonboard

Coordinated effects: the U.S. Guidelines

- Adverse competitive effects arising in this manner are referred to as "unilateral effects." A merger also can enhance market power by increasing the risk of coordinated, accommodating, or interdependent behavior among rivals. Adverse competitive effects arising in this manner are referred to as "coordinated effects." In any given case, either or both types of effects may be present, and the distinction between them may be blurred.

- Coordinated interaction includes … the explicit negotiation of a common understanding … a [tacit] understanding … enforced by the detection and punishment of deviations … alternatively [it] can involve parallel accommodating conduct not pursuant to a prior understanding [including] situations in which each rival's response to competitive moves made by others is individually rational, and not motivated by retaliation or deterrence nor intended to sustain an agreed-upon market outcome, but nevertheless emboldens price increases and weakens competitive incentives to reduce prices or offer customers better terms. The ability of rival firms to engage in coordinated conduct depends on the strength and predictability of rivals' responses to a price change or other competitive initiative. Under some circumstances, a merger can result in market concentration sufficient to strengthen such responses or enable multiple firms in the market to predict them more confidently, thereby affecting the competitive incentives of multiple firms in the market, not just the merged firm.

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Coordinated effects: recent FTC enforcement

- *CCC/Mitchell* (2009)
  - 3:2 in automobile damage estimation software (65-70% merged firm share)
  - FTC complaint focuses on unilateral effects in District Court (*loses*) but also alleges coordinated effects (*wins*) (!)
  - Customer allocation theory
- *CSL/Talecris* (2009)
  - 5:4 in four plasma-derivative protein therapies (post-merger CR2 = 80%)
  - Pure coordination theory: target is 'aggressively expanding' and the 'only significant threat to this durable and highly profitable oligopoly' (Complaint)
  - '[F]it so squarely … that alleging both theories would not make sense' (Comm. Rosch)
- *Carilion Clinic* (2009)
  - 3:2 in outpatient surgical and imaging services in Roanake, Va.
  - Unilateral effects *and* stable duopoly and removes only non-hospital-owned rival
- *LabCorp/Westcliff* (2010)
  - 3:2 in lab services to managed care physicians in Sth. Calif. (Nov 2010 complaint)
  - Unilateral effects *and* loss of a maverick

Non-coordinated effects: the *T-Mobile* case (EU)

T-Mobile/Tele.ring (2006 Phase II remedies)

- tele.ring, as a maverick … punches above [10-20%] market share
- Non-coordinated effects from: elimination of tele.ring … and the emergence of a market structure with two large network operators of similar size [30-40% merged firm v 35-45% Mobilkom], a far smaller one [One, 15-25%] and a very small operator [H3G, <5%]
- One/Yesss! (premium positioning with existing spare capacity) lacks incentive to replicate tele.ring and H3G lacks ability to do so
- Probable … tangible effect on prices … Even if prices do not rise in the short term, the weakening of competitive pressure as a result of tele.ring's elimination from the market makes it unlikely that prices will continue to fall significantly as in the past
- Does not rule out the possibility that … besides producing the non-coordinated effects .. may also lead to a weakening of competitive pressure as a result of coordinated effects. These coordinated effects would result in prices on the market rising higher than if they were dictated only by the individual, non-coordinated, profit-maximising behaviour of each individual competitor
- Two network operators of roughly equal size … and remove the price-aggressive maverick … however, there is no need to [decide] … as the commitments … rule out the possibility that the transaction will lead to coordinated effects …

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Multilateral effects: the *Eggs* case (UK)

Stonegate/Deans (2007 CC prohibition)

- In addition to … unilateral effects [44 + 28 = 72%] we considered whether the merger could result in a multilateral increase in prices to retailers – i.e. increased prices … also by other suppliers. Several factors suggest multilateral effects are likely … Although prices are not transparent, but negotiated with both suppliers and customers, it is nonetheless easy for suppliers to identify the effects of each other's actions when an order is lost, if not necessarily during the process of negotiation. It is likely to be in the interests of other suppliers of shell, of free range and of organic eggs to retailers, particularly given their difficulty in acquiring eggs in the short term, at least in part to follow a price increase by the merged company rather than maintain, or reduce, their prices to increase market share. In our view, therefore, the merger would be expected to have the effect of enabling other suppliers of shell, of free range and of organic eggs to retailers to attain higher prices than would otherwise be the case. The above outcome does not require any form of coordinated behaviour, but could emerge purely from the actions of the suppliers in the market responding to one another's prices.

- This is an industry characterized by a relatively small number of suppliers, with considerable knowledge of each other's operations, and which cooperate actively on a number of industry bodies such as the BEIC and the CEA, hence we considered whether the merger could give rise also to coordinated effects. But given our conclusion … [on] unilateral and multilateral effects, we have not needed to reach a final view on whether coordinated effects may also be expected.

I used to be decisive … but now I'm not so sure, or

Minority Stakes and the New Gap

Why Is This Non-Convergent? Should the EUMR be Patched? If So, How?

Aer Lingus v Commission

The Court on minority stakes as part of bids for control

– In its Art 8(3) prohibition of *Ryanair/Aer Lingus*, EC defined as a 'single concentration' *both* acquisition of ~25% minority stake *and* the bid for control, then blocks the 'concentration'

– All agree that the ~25% stake itself does not confer decisive influence a.k.a control

– Aer Lingus argues that EC has power to order divestment of (most of) the ~25% stake, saying that the stake continues to be the *implemented part* of the 'concentration' as defined, reviewed and declared incompatible by the EC

– Court agrees with EC that what's left over once the bid is blocked 'cannot be assimilated to a concentration which has already been implemented even if the operation by which that shareholding was acquired has been declared incompatible' so EC has no power to act: Art 8(4) refers only to a '*concentration*'

– By the same token, Court makes clear that Art 21(3) exclusivity of EUMR lapsed and NCAs can apply national laws to the non-concentration

Ryanair v OFT

Timed-out mechanics

– Ryanair argues that a deadline is a deadline, and 4-month OFT clock did not stop while appeals went through the Luxembourg appeals process (3 years)

– OFT argues that sincere duty of co-operation under EU Treaty and risk of inconsistent outcomes meant the clock stopped, until appeal period expired for appeal to ECJ

– Had Ryanair won *its* appeal, the UK would have dealt with the minority stake and thereby trampled on Ryanair's right to have the Commission re-examine the *whole* concentration on remittal

– Had Aer Lingus won *its* appeal, the UK would have examined an implemented part of a ongoing concentration and trampled on ground covered by Art 8(4) EUMR

– But both airlines lost. Anyhow, s 122(4) of the Enterprise Act makes 'clear' that

The condition mentioned in this subsection is that, because of the EU Merger Regulation[s] or anything done under or in accordance with them, the reference … could not have been made earlier than 4 months before the date on which it is to be made.

Non-controlling stakes: an EU lacuna?

One-stop shop mechanics

– Assume A (20% market share) and B (80% share) are duopolists and A acquires a 24% "material influence" stake in B. If A completes on another 76% controlling stake, it has transitory control over B (and an implemented concentration)

– If this is a SIEC the EC believes it has power to roll back A's stake in B down to [as low as zero] as Article 8(4) provides for restoration of effective competition … defined in *Tetra* and *Schneider* as requiring the *status quo ante* (0%) or close (<5%)

– *Tetra/Schneider paradox*: from an EU perspective, both firms got to keep less than they could have got if they had acquired safely below decisive influence (say, up to 20%) *ab initio*

– See also UK examples (*Sky/ITV* at 7.5%, and Tesco, Asda bids in *Safeway* (blocked and CC prevented them from acquiring 3%+ stake)

– *A-B paradox:* But if A acquires 24% and then does not *complete* a bid but just *makes* a bid for the rest, A started out with less than (transitory) control and so its 24% stake is safe from the EUMR … as it's no longer part of a concentration

Non-controlling stakes: an EU lacuna?

One stop shop mechanics

– Producer welfare. Best advice to A might be: if not active in UK or Germany, you can buy 24% of your closest rival (deal typically falls outside all other NCA regimes) and make a bid for control. If the EU blocks perhaps you get to keep 24% as consolation because merger control is out, Art 102 is out for a non-domco and Art 101 requires a meeting of minds

– Consumer welfare

– What should matter is ex post: the end game effect on competition, net of all EU intervention (competition restored or durable harm).

– What does matter is ex ante: whether A started out with (transitory) control prior to EU remedial intervention, usually a function of disparate national takeover laws.

– This is very bad policy: consumers live in the *ex post* world not the *ex ante* world.

– But if (somewhat randomly), the UK and/or Germany have jurisdiction, they can review the 24% now that EU bid is blocked. Unless they are out of time.

Mergers of Close Competitors: Market Definition And the Lesser of the Two Evils

The *Whole Foods* Dilemma

- **Backing unilateral effects cases into narrow 3:2 and 2:1 markets worked**
  - 1997. In *Staples/Office Depot*, the FTC defined an office supply superstores market (3:2 competitor set: parties + OfficeMax). It wins.
- **Until it didn't**
  - 2001. In *SunGard/Comdisco*, DOJ chooses shared hotsite disaster recovery services for large scale enterprise computer processing centers (3:2 competitor set: parties + IBM). It loses on market definition.
  - 2004. In *Oracle/Peoplesoft*, DOJ chooses high-function FMS and HRM software (of the type only the parties + SAP can supply) (3:2 competitor set). It loses on market definition.
  - 2007. In *Whole Foods/Wild Oats*, FTC chooses premium natural and organic supermarkets (2:1 competitor set: parties, mainly). It loses on market definition.

The UK and *Whole Foods*-type cases

- *Waterstone's/Ottakar's* (2005)
  - OFT: '#1 + #2' national and local markets for specialist (aka large-range book) retailers
  - CC: national market for the sale of books via all outlets (24%)
- *Game/Gamestation* (2006)
  - OFT: extremes - 2:1 local markets for specialist retailers vs. all outlets, national (40%)
  - CC: national market for supply of all PC games through all outlets
- *Holland & Barrett/Julian Graves* (2009)
  - OFT: '#1 + #2' national and local market for sale of nuts, seeds and fruit (NSF) via specialist retailers
  - CC: national and local markets for NSF via all retailers, including supermarkets
- *Sports Direct/JJB Sports* (2010)
  - OFT: mostly 3:2 local markets for specialist sports chains (e.g. parties, JD Sports)
  - CC: '2 to 1' local markets of 'Sports Direct + JJB Sports'
- *Zipcar/Streetcar* (2011)
  - OFT: '#1 + #2' London market for car clubs
  - CC: '#1 + #2' market for car clubs, but notes 'Zipcar + Streetcar' (2:1) would pass HMT

The *Whole Foods* Dilemma

Latest US thinking

– Defining a market broadly … can lead to misleading market shares … competitive significance of distant substitutes is unlikely to be commensurate with their shares in a broad market. Although excluding more distant substitutes from the market inevitably understates their competitive significance to some degree, doing so often provides a more accurate indicator of the competitive effects of the merger than would the alternative of including them and overstating their competitive significance as proportional to their shares in an expanded market. (U.S. HMG)

Latest UK thinking

– Market definition is now a looser more descriptive exercise … mainly focused on forming the backdrop .. emphatically not a precursor to measuring concentration
– If we are going to be using unadorned market shares, then you need to be looking at a SSNIP-defined market
– OFT/CC 'may use market shares and measures of concentration, assessed on the relevant market *or another market* (in particular the *narrowest* [HMT] market') (UK Guidelines, 5.3.1)

Non-Horizontal Enforcement: Alive and Well in Europe

EU conglomerate enforcement: *Intel/McAfee*

Interoperability remedy (Jan 2011)

– Concern: Intel, with market power in CPUs and chipsets will bundle or embed (technically tie) McAfee's security solutions (one of top two players)

– As remedy, Intel committed:

(1) that rival security vendors have access to all necessary data to use functionalities of Intel's CPUs and chipsets in the same way as those functionalities used by McAfee;

(2) not actively to impede rival security solutions from running on Intel CPUs or chipsets;

(3) to avoid hampering the operation of McAfee's security solutions when running on PCs with non-Intel CPUs or chipsets

– **5-year worldwide** duration with trustee monitoring

– "The commitments … strike the right balance, as they allow preserving both competition and the beneficial effects of the merger." Commissioner Almunia

– NB **interoperability** solves **horizontal** concerns in *Cisco/Tandberg*

– EU remedy was a publicly-cited reason cited for the DOJ closing its case (cf. *Oracle/Sun*)

– In *Intel/McAfee,* cooperation with FTC but no (need for?) FTC remedy

EU vertical enforcement: *Syngenta/Monsanto*

Background

– Article 22 referral from Spain and Hungary (biggest sunflower growers in EU)

– Sunflower seeds sales (horizontal) and trading of sunflower varieties (vertical concerns)

– Merger = largest/broadest germplasm portfolio in the EU (45-55%, 70-80% of parental lines)

– Third party genetic material critical for becoming active on downstream seed sales market, esp. for SME seed companies and entrants, and merger is likely to lead to partial or complete input foreclosure as Syngenta would likely license and exchange less, and/or impose less favourable prices and other terms

Remedies (Phase II, Nov 2010)

– Purchaser of divestment business to solve horizontal concerns will have the right to license both existing and newly developed parental lines to third companies EU-wide

– Package exceeds the # of parental lines currently licensed by target

– Parental lines mainly relevant to the referring country markets of Spain and Hungary, so "particularly well tailored to address the foreclosure concerns with respect to those two Member States, on which the analysis of the Commission focused" (Art 22 mandate)

U.S. behavioural remedies

- *Comcast/NBC Universal* (vertical, 2011)
  - License programming to online competitors to Comcast's cable TV services
  - Anti-retaliation provisions, adhere to Open Internet requirements
- *Ticketmaster/Live Nation* (vertical, 2010)
  - Anti-retaliation against venue owners who deal with rivals, and anti-tying of Live Nation promotion with Ticketmaster ticketing
  - No use of ticketing data in non-ticketing business, or provide data to other promoters/artist managers and provide data promptly to non-renewing clients
- *GrafTech/Seadrift* (horizontal, 2010)
  - Firewall and reporting remedy, removal of MFN and audit rights for 10 years
- *Carlyle/Riverstone/Kinder Morgan* (minority stake, 2007)
  - C and R owned 50% of the general partner that controls Magellan, a rival to Kinder Morgan, in which they acquired 22.6% stake
  - Magellan side: remove reps from board; cede control to other investor; not influence or attempt to influence management or operators; firewall to prevent info exchange

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Has the UK's Rivalry-based SLC Test Stepped Out of Transatlantic Sync?

Should any new UK Test be a SAIC test? (significant adverse impact on customers)

Why effects analysis? Convergence.

- … unifying theme of these Guidelines is that mergers should not be permitted to create, enhance, or entrench ***market power*** or to facilitate its exercise … a merger enhances market power if it is ***likely to*** encourage one or more firms to raise **price**, reduce **output**, diminish **innovation**, or otherwise ***harm customers*** as a result of diminished competitive constraints or incentives *U.S. 2010 Guidelines at 1*

- Through its control of mergers, the Commission prevents mergers that would be ***likely to deprive customers of these benefits*** by significantly increasing the ***market power*** of firms. By "increased ***market power***" is meant the ability of one or more firms to profitably increase **prices,** reduce **output, choice** or **quality** of goods and services, diminish **innovation** … *EC 2004 Guidelines at 8*

- A merger may be expected to lead to a SLC when it is ***expected to weaken rivalry*** to such an extent that ***customers would be harmed.*** This may come about, for example, through reduced **choice**, or because **prices** could be raised profitably, **output** could be reduced and/or product **quality** or **innovation** could be reduced. *OFT 2003 Guidance at 3.7*

Why effects analysis? Divergence.

- An SLC is ***not defined by its effects on the outcomes*** of the process of competition, such as **prices**. In other words, it is ***not an adverse effect on the outcomes*** of the process of competition (e.g. **prices**) that differentiates an SLC from a lessening of competition; it is an ***adverse effect on rivalry***. Whether a ***reduction in rivalry results in an SLC will depend on the extent of the reduction.*** *UK April 2010 Joint Draft Guidelines at 4.5*

- Regardless of how enhanced ***market power*** likely would be manifested, the Agencies normally ***evaluate mergers based on their impact on customers***. The Agencies examine effects on either or both of the direct customers and the final consumers. The Agencies presume, absent convincing evidence to the contrary, that ***adverse effects on direct customers*** also cause ***adverse effects on final consumers***. *US 2010 Guidelines at 1*

Why effects analysis? Convergence?

– The Authorities will consider any merger in terms of its ***effect on rivalry*** over time. Many mergers are either pro-competitive or benign in their ***effect on rivalry***. But when levels of rivalry are reduced, firms' competitive incentives are dulled, to the ***likely detriment of customers*** … A merger gives rise to an SLC when it has a ***significant effect on rivalry over time***, and therefore on the competitive pressure on firms to improve their offer to customers or become more efficient or innovative. A merger that gives rise to an SLC will be expected to lead to an ***adverse effect for customers***. Evidence on likely ***adverse effects*** will therefore play a ***key role*** in assessing mergers
  – *UK Joint Guidelines 2010 at 4.1.3*