Aalto University
School of Business

Merger control - some insights

Prof. Petri Kuoppamäki, LL.D

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Case example: Outokumpu/Inoxum

- Beginning of 2013 a merger was notified to the European Commission. Outokumpu had agreed to buy Inoxum, the stainless steel division of Thyssen Group.
- In May 2013 the European Commission opened an in-depth investigation under the EU Merger Regulation into the proposed acquisition of Inoxum, the stainless steel division of ThyssenKrupp of Germany by the Finnish stainless steel company Outokumpu.
- The Commission's preliminary investigation indicated potential serious competition concerns in various markets for the production and distribution of stainless steel flat products, where the merged entity would have very high market shares.

Outokumpu/Inoxum continued

- Following an in-depth review, the European Commission cleared the proposed acquisition. However, the approval was conditional upon the divestiture of Inoxum's stainless steel production facility in Terni, Italy. The Commission had concerns that the combination of the two largest suppliers of cold rolled steel products would have given the merged entity the power to raise prices. The commitments offered addressed these concerns.
- *“Stainless steel is a key material for a wide range of products, from household goods to industrial equipment, and an essential input for many European industries. The divestment of the Italian Terni plant ensures that the creation of a new European market leader will not be detrimental for consumers and businesses in Europe."* said Joaquín Almunia, Commission Vice President in charge of competition policy.
- The Commission's in-depth investigation focused on the production of cold rolled stainless steel products in the European Economic Area (EEA). In this market, the merger will combine the first and the second largest supplier. The transaction, as initially notified, would have created a player three times as big as Aperam of Luxembourg and five times as big as Acerinox of Spain, the closest competitors and respectively the third and fourth player in the market.

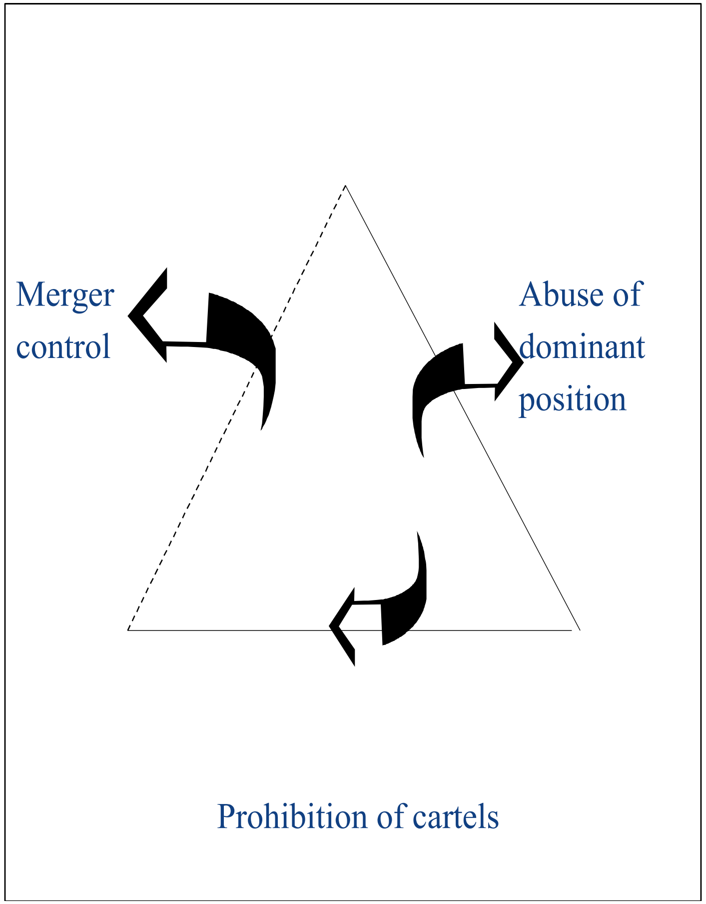
Outokumpu/Inoxum

- The Commission's investigation found that while imports account for an appreciable part of the EEA market, they are insufficient to constrain price increases, because they are generally not considered fully substitutable by final customers. Moreover, despite their level of spare capacity, it is likely that the two main European competitors of the parties, Aperam and Acerinox, would have found it more profitable to follow price increases by the merged entity rather than competing sufficiently aggressively to prevent them. Price increases resulting from the transaction, as initially notified, would have likely been much higher than any potential synergies.
- In order to address these concerns, the parties offered to divest Inoxum's stainless steel plant in Terni and a number of distribution centres in Europe. The divestment will provide the purchaser with a fully integrated, stand-alone production and distribution business, having access to all major EEA countries. At the option of the purchaser, the divestment will include Terni's forge (*Societa' delle Fucine*) and the large bright annealing line LBA2. The Commission will make sure that this business is sold to a suitable purchaser, as provided in the EU Merger Regulation, and will check that Terni's viability and competitiveness is ensured.
- The proposed commitments ensure that the merged entity will continue to face a sufficient competitive constraint in the market for the production of cold rolled stainless steel products in the EEA. The Commission therefore concluded that the proposed transaction, as modified by these commitments, would not raise competition concerns. The decision is conditional upon full compliance with the commitments.

Focus of the seminar work

- At the end the ”crown jewel” had to be divested
- The seminar work could focus on following issues:
  - Why was this merger allowed only under significant divestments?
  - Was the decision a correct one?
  - Is the decision similar or different than in previous merger cases in the same industy? Was it expected or not?
  - What about efficiency defence in a merger context?
  - What went wrong from Outokumpu's point of view? How could the internal process be improved?
  - What has been the sentiment of the business media?
  - A separate complaint regarding Commission's process was filed to the Hearing Officer of the European Commission. What was the outcome and what do you think about it?
  - What should business executives know about merger control and about competition/antitrust law at large?

Triangle of Competition Law



Why competition law?

- **Competition law** exists to protect the process of **competition** in a free market economy
  - A system where the allocation of resources is determined mainly by supply and demand in free markets
- **Competition** wanted because of the market result it produces
  - Efficiency
  - Low prices
  - Innovations
  - Freedom of action
- **Competition** rules limit the freedom of the market players in order to protect the process of **competition**; yet at the same time it preserves freedom of others (e.g. by enabling market entry or preserving choice for customers and ultimate consumers)

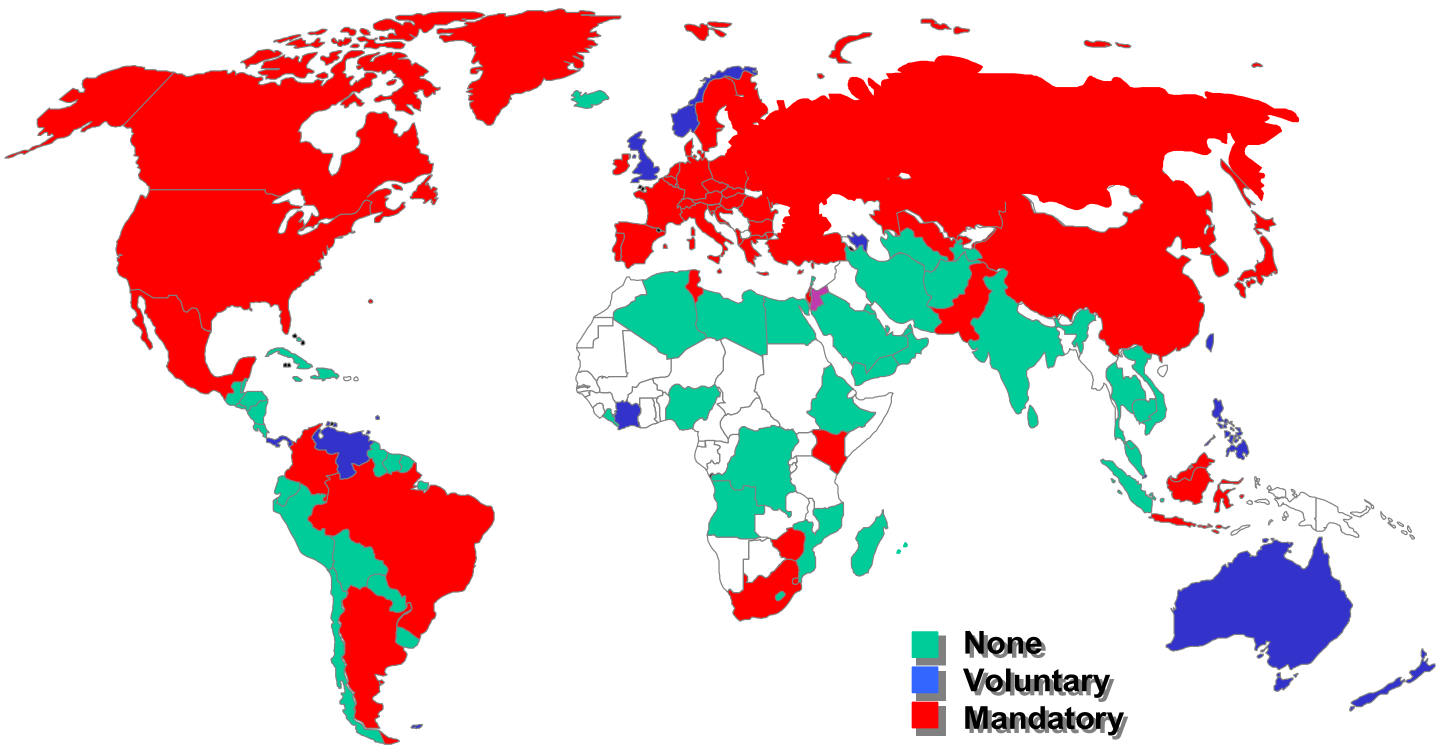
Key principles of Merger Control

- **Mandatory notification**: Large concentrations meeting certain monetary thresholds need to be notified to the competition authorities
  - EU: combined worldwide turnover of the merging parties exceeds 5 billion euros and at the turnover of at least two parties exceeds 250 million euros in the EU and less than 2/3 of the turnover is in one single Member State; or all parties' worldwide turnover exceed 2,5 billion euros and the aggregate turnover of the parties exceeds 100 million euros in at least 3 EU Member States and each of the parties has at least a 25 million turnover in these 3 Member States
  - Under national rules turnover figures are significantly lower
- **Implementation ban**: the merger may not be put into effect before in has been cleared by the competition authorities having jurisdiction over the case: **Phase 1**: about five weeks from ”effective notification date”; **Phase 2**: in case of ”significant doubts ” three additional months (additional time in case of transfers, remedies etc.)

Key principles continued…

- **Protection of competition**: the merger is prohibited if it leads to a dominant position or otherwise significantly impedes effective competition in the relevant market; instead of a prohibition the transaction can be cleared conditionally (based on remedies proposed by the merging parties) to remove the competitive concerns
- **One stop shop**: if the EU thresholds are met only EU Commission has jurisdiction over the case <u>within the EU</u>; in certain cases can be transferred to the EU or to national authorities
- **Notifiable ”Concentrations”**
  - Change of control on a lasting basis
  - Share acquisition(> 50 %, also a smaller share can lead to ”effective control”)
  - Mergers and takeovers
  - Setting up a joint venture (sole or joint control, note shifting alliances and non-full functional entities)
  - Asset transfers, sale of a business line
- **Horizontal,vertical and conglomerate mergers**
- **Idea: Block such mergers that would lead to a price increse on the relevant product and geographic market or otherwise significantly harm effective competition**

The world of merger control



EU Merger Control Rules

- Merger Control Package:
  - Regulation 139/2004
  - The Horizontal Merger Guidelines
  - The Vertical Merger Guidelines
  - The Best Practices
  - Implementing Regulation
- Reorganization of DG Competition:
  - More emphasis on economic analysis (Chief economist)
  - “Scrunity Panels” in critical cases
  - Abolished Merger Task Force
- Other Notices:
  - Notice on allocation of cases between the Commission and NCAs
  - Notice on ancillary restrains
  - Notice on simplified procedure for concentrations that do not raise any competitive concerns

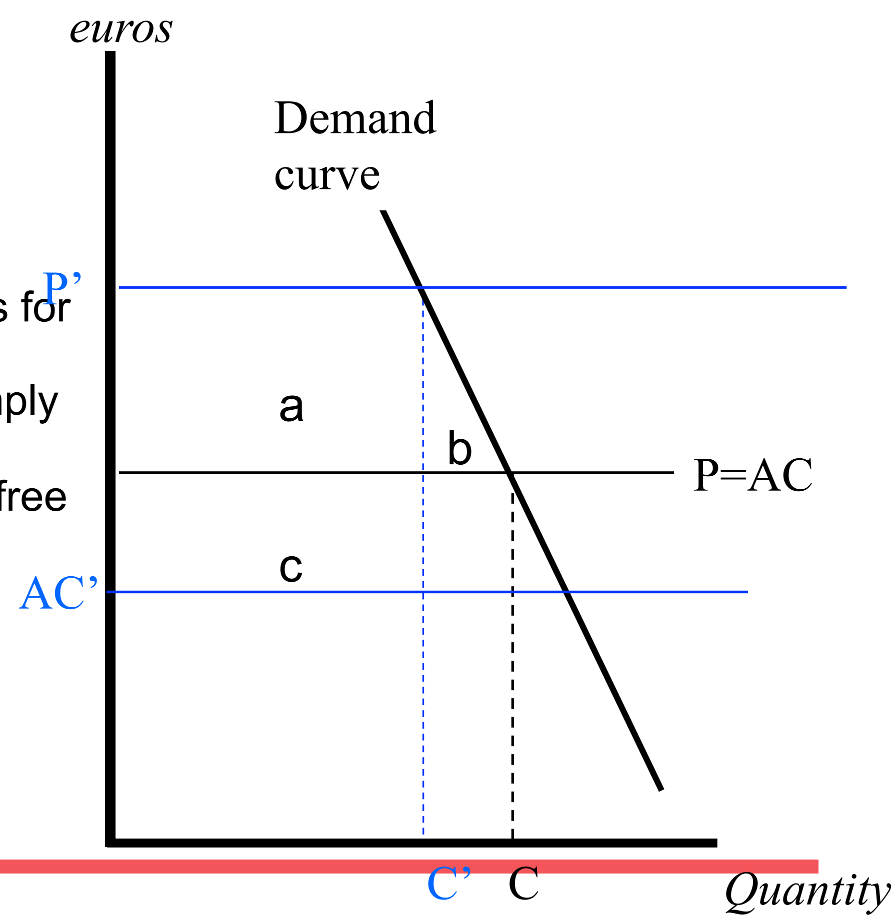
The key tests

- In EU, mergers judged on whether they:
  - *"… significantly impede effective competition … in particular by the creation or strengthening of a dominant position …"*
- In other jurisdictions, it varies but often either dominance test or, e.g. in UK, US: *"substantial lessening of competition"*
- However phrased, it's about market power:
  - unilateral or co-ordinated effects

Merger control (economics)

- Initially “P=AC”.
- Merger implies lower AC to AC’ , and increased price to P’ .
    - –Good for the cartel (profit from “zero” to a+b)
    - –Bad for customers (loss of consumers surplus for a+b)
    - –Net welfare to the society is c-b since a is simply transferred from consumers to firms
- Dynamic view (in US and increasingly in EU); if free entry then eventually P driven down to AC’
- A lot depends on barriers to entry
- Predicting the future is not easy…

Williamson’s diagram



The Horizontal Guidelines

- Possible anti-competitive effects of horizontal mergers:
  - Non-coordinated effects:
    - Merger eliminates competitive constrains, which consequently have increased market power
    - Creation of or strengthening of the dominant position of a single firm
    - Factors that may influence are i.e. large market shares of the merging parties, parties are close competitors, the customers have limited possibility to switch suppliers…
  - Coordinated effects:
    - Changes the nature of competition, firms are more likely to coordinate their behavior and thus harm effective competition
    - Coordinating may involve i.e. maintaining or raising prices above the competitive level, limiting production or capacity, dividing markets or sharing bids.
- Efficiencies in overall assessment of the merger
  - Efficiencies must be pro-competitive, benefit consumers and verifiable

Single dominance

- Single dominance Main criteria:–Market share (both volume and value sales)< 25% no single dominance> 50% dominance–Evolution of market share–Overall size of the undertaking–Control of infrastructure not easily duplicated (essential facility)–economies of scale and economies of scope–vertical integration
- Other criteria:–technological advantages or superiority–absence of or low countervailing buying power–easy or privileged access to capital markets/ financial resources–product/services diversification–absence of potential competition (barriers to entry) –a highly developed distribution and sales network–barriers to expansion

Collective dominance

Competition authorities analyse:

(a) whether the characteristics of the market makes it conducive to tacit coordination; and

(b) whether such form of coordination is sustainable over time.

- Main criteria:-mature market-stagnant or moderate growth on the demand side-low elasticity of demand-homogeneous product and similar cost structures-similar market shares-various kind of informal or other links between the undertakings concerned-retaliatory mechanisms-lack or reduced scope for price competition

Unilateral effects

- Unilateral effects: the merged group is able profitably to reduce value for money, choice or innovation through its own acts without the need for a co-operative response from competitors
- Also known as non-coordinated effects
- US “Baby Foods” case
- Was added to EC merger rules in 2004 and in Finland in 2010
- The point here is that the Commission does not need to prove market dominance
- Ability to unilaterally raise prices in differentiated oligopoly situation
- How big is the gap between single dominance and joint dominance
- Compare single/joint dominance and non-coordinated/coordinated effects
- Sofar ”unilateral effects” a decisive factor only in a handful EU cases

Vertical and conglomerate mergers

- Vertical mergers have normally less potential for harmful effects than horizontal mergers between competitors, but gaining control of a key asset that other competitors need can sometimes block competitors a key asset
- Non-horizontal guidelines: a) ability and b) incentive to exclude downstream competitors by worsening access to a key asset
- Control of raw material or another asset that also competitors need in competing downstream with the merged entity
  - Importance of the controlled asset?
  - Refusal to deal?
  - Price squeeze?
  - Price advantage?
  - Alternative source of supply?
  - Efficiency defence?
- E.g. Tom Tom/Teleatlas and Nokia/Navteq
- Conglomerate mergers: does the merged group have the ability and incentive to leverage market power from one market into a second?
- Normally conglomerate mergers do not raise any competition concerns

Merger control and the sale of IP rights

- Normally the sale of IP does not constitute a notifiable merger
  - Patents (part of a bigger portfolio, no separate ”annual turnover”)
  - Trademarks (you need more to run a business…)
  - Copyright (you need more to run a business…)
- However, a sale of a ”business line” does constitute a notifiable transaction
- For instance, in exceptional circumstances the sale of a trademark, in particular if done in conjunction with transfer of personnel can create a notifiable transaction (e.g. Coca Cola Company and Cadbury Schweppes, 1999)
- Licensing arrangements sometimes constitute a remedy to alleviate competition concerns; sale of IP rights or a long-term, stabile licensing arrangement can create a new source of supply and restore competition in the market