
Workshop on Competition Act 2002

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Mergers & Acquisition – a legal perspective

by

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Concepts

- Ownership of two or more enterprises joined together
- Can be amicable and consensual
- Can also be hostile and unwelcome
- Consolidation of business activities
- Enhancement of market share
- Enhancement of market power
- Economic analysis is key to assessing a merger
- Legal scrutiny follows thereafter

Two basic questions@

- Which transactions are subject to review under merger control laws
- How should the substantive legal test – against which mergers should be assessed – translate into a competition test?

@ICN Merger Guidelines Workbook – April 2006

Answer 1

- Whether joint ventures (JVs) are reviewed as mergers and/or agreements depends upon national law. Where they are treated as mergers, the analysis of it will be identical to that of any other merger control.
- The Indian Competition Law puts JVs under the anti-competitive agreements and not under mergers (combinations)
- ICN Workbook forewarns that when JVs are not mergers, then thresholds for JVs must be as clear as possible to minimize uncertainty.

CC,UK - JV

- Press Release of the CC, UK 4 May 2007
- Kemira GrowHow Oyj (Kemira) and Terra Industries Inc (Terra) – JV
- Bob Turgoose, Inquiry Group Chairman, commented:
“ *We had to examine how this JV would affect competition in relation to a number of different products. While agricultural fertilizer customers would still have alternative through imports, but the market share in other products would be very high and customers would be affected substantially. The JV can take advantage of the position and raise prices to the detriment of the customers*”

Kemira & Terra JV

- A summary of provisional findings had been published in the CC's website
- CC had given up to 25 May 2007 time to all interested parties to comment on the provisional findings and suggest possible remedies, if any
- CC is expected to publish its final report by 12 July 2007
- A very transparent method

Answer 2

- CCI must be in a position to explain how to identify those situations where a merger will not pass the relevant competition test.
 - Most mergers do not harm competition
 - Some may be pro-competitive and benefit consumers by lowering costs and/or increasing innovation
 - Many other are competitively neutral – e.g., post-merger competition will remain and continue to discipline the merged firm and its rivals
 - Over 90% cases are allowed unconditionally and out of remaining 10% bulk are allowed with modifications

Answer 2 (contd.)

- Mergers can have anti-competitive effect on market, enhancing market power of the merging parties thus harming consumers
- Competitive harm
 - Unilateral effects
 - Coordinated effects

Unilateral effect

- Allow the merged entity to unilaterally exercise market power
- Consequent upon elimination of competition between the merging parties, merged entity is able to profitably rise price, or reduce output or quality or variety

Case Law (Irish Competition Authority)

IBM/SBCS (2004)

The Irish CA blocked the deal. The Authority found that the merging parties were the two closest competitors and that the elimination of the competitive constraint provided by SBCS would have harmed customers in a significant way. It was found through analysis that – barriers to entry were high; market was such that only the merging parties were able to provide high reliability of service and quality and switching costs were high since moving to other suppliers would have undermined the relationship with their current supplier.

Case Law (EC)

Volvo/Scania (2000)

It was a case of an acquisition of truck producer Scania by Volvo. EC found that the merger would have led to very high combined market shares (over 50%) in a number of Northern European countries. Investigation on market also showed that in these countries Volvo and Scania were each other's closest competitors, pursuing similar strategies and with a very similar brand image. EC found that the proposed merger would have led to increased prices in the market for heavy trucks.

Coordinated effects

- The merger increases the probability that post merger, merging parties and their competitors will successfully be able to coordinate their behaviour in an anti-competitive way – e.g., by raising prices. Issue is not market power, but instead whether the merger will strengthen certain market conditions
- Where a merger reduces competitive constraints in a market thereby strengthening the conditions that facilitate the ability of competitors to coordinate their competitive behaviour to the disadvantage of consumers
- The main question should be whether the merger materially increases the likelihood that firms in the market will successfully coordinate their behaviour or strengthen existing coordination

Case Law (South Africa)

South African Banks/Compcorp (2004)

Four SA's banks sought approval for the establishment of an industry-wide switch for electronic submission of mortgage bond through a company – Compcrop. All mortgage applications by the banks would have to be submitted via a single channel – the switch. The banks also intended to acquire the Bond Trak software used by mortgage originators in managing their processes. The Commission found:

- 1. Joint control of Compcrop would create a platform for coordinated conduct likely to lessen inter-bank competition*
- 2. The banks would be able to jointly fix a transaction fee*
- 3. Parties pleaded efficiencies, but the Commission found the same could be attained outside the merger and these efficiencies did not outweigh the anti-competitive effects arising from the mergers*
- 4. Prohibited the merger notification*

Impact

- Acquirer benefits through enhanced market share and power
- Competitors affected because of new market dynamics
- Repositioning of suppliers and distributors
- Price, quality and availability of the product and/or services affect customers and end consumers
- Workers & employees of enterprises in pre-merger and post-merger scenario

Indian legal provisions

- Section 5 – Acquisition, Mergers, Acquiring control and Amalgamation – together called ‘combinations’
- Combinations to be ‘regulated’ and not ‘prohibited’
- Thresholds prescribed for assets and turnover
- CCI can initiate *suo motu* action
- *Ex-ante* action unlike *ex-post* in cases of anti-competitive agreements and abuse of dominance

Indian legal provisions (contd.)

- Combinations causing or likely to cause appreciable adverse effect on competition in relevant market in India are void – section 6
- 14 factors have been given under section 20(4) of the Act to determine AAEC
- Factors of relevant market – product and geographic are also defined under section 19(5) to (7) r/w Sec 2(r),(s) & (t)
- Prima facie case has to be established - section 29
- Notification by the acquirer is voluntary but once given within 7 days of the approval or agreement, as the case may be, within 90 working days the Commission has to pass the order otherwise the Combination would be deemed to have been allowed. Section 6, 29, 30 & 31.

Cross border cases

- Are also covered – section 32
- Proviso to section 18 empowers Commission – with prior approval of the Central Government – to enter into arrangements with foreign agencies to share information on anti-competitive practices – international cooperation

Remedies

- The Commission shall pass orders on combinations under section 31
- It may allow, modify or reject a proposal of combination by order
- Failure to comply with the order of the Commission may lead to penalties provided under Chapter VI of the Act
- In case of overlap of jurisdictions – the Commission is empowered to deal with such a situation provided the matter is referred to by such authority which desires to resolve the overlap – section 21
- Aggrieved by the Order of the Commission, right to appeal lies before the Supreme Court [*before CAT proposed amendment*]

Types of mergers

- Horizontal
- Vertical
- Conglomerate

Horizontal mergers

- Between enterprises that are competitors at the same level of production and/or distribution of a good or services i.e., in the same relevant market
- Focus of analysis is on evaluating how the competitive incentives of the merging parties and their rivals might change as a result of the merger

Horizontal mergers (contd.)

- The merging parties may realize efficiency gains; may result in intense rivalry and be beneficial to consumers
- It is the task of the Competition Authority to ensure that the merger is not likely to enable firms to harm consumers or customers by profitably raising prices, reducing quality or restricting innovation

Vertical Mergers

- First type of non-horizontal mergers
- It is a merger between firms that operate at different but complementary levels in the chain of production (e.g., manufacturing and an upstream market for an input) and/or distribution of the same final product
- No direct loss in competition because products did not compete in the same relevant market
- No change in level of concentration in either relevant market

Vertical mergers (contd.)

- Have significant potential to create efficiencies largely because the upstream and downstream products/services complement each other
- Competition concerns
 - whether vertical merger is expected to force rivals from the markets
 - raise their costs levels or raise barriers to entry in a manner that lessens competition – *market foreclosure effects* in some jurisdictions

Vertical mergers (contd.)

- May increase the ability and incentive of firms to coordinate their behaviour in a market in a harmful way for consumers (or customers)
- Fundamental questions
 1. whether or not there is pre-existing market power at one or more levels of the supply chain;
 2. which theory of competitive harm is likely to be relevant in a specific case (unilateral or coordinated);
 3. does economic incentives of parties change as a result of the merger

Conglomerate merger

- Second type of non-horizontal merger
- Involve firms that operate in different product markets, without a vertical relationship
- Mergers between firms that produce different but related products
- Mergers between firms operating in entirely different markets – pure conglomerate mergers

Conglomerate mergers (contd.)

- Competitive harm needs to be supported by substantial evidence
- There may be real risk of foregoing efficiency gains that benefits consumer welfare if the issues are not properly investigated

International practice

- Non-horizontal mergers are generally less likely to create competition concerns than horizontal mergers
- Non-horizontal mergers do not entail the loss of direct competition between the merging firms in the same relevant market
- Main source of anti-competitive effect is absent

International practice (contd.)

- Provide substantial scope for efficiencies
- Products and/or services are complementary
- Integration of complementary activities or products within a single firm may produce significant efficiencies and hence pro-competitive
- It may reduce transaction cost

EC's latest draft guidelines

- On non-horizontal mergers [*published in Competition Policy Newsletter 2007 Number 1 Spring*]
- One of the important objectives of the guidelines is to provide firms with guidance not only about possible theories of harm but also to enable them to identify mergers that are unlikely to be challenged on competition grounds
- The draft says that these mergers pose no threat to effective competition unless the merged entity has the market power in at least one of the markets concerned

EC Draft guidelines (contd.)

- Draft specifies “*safe harbours*” as a screen to identify cases that are clearly unlikely to raise competition issues.
- Where market share post-merger of the new entity in each of the market concerned is below 30% and HHI is below 2000
- Such mergers will not be investigated unless some special circumstances arise

EC draft guidelines (contd.)

- EU Member States adopted the draft guidelines after series of initial consultations amongst them
- It has now been put on public domain which gives an opportunity to the general public to participate in the debate
- It is available on DG Competition's website under [<http://ec.europa.eu/comm/competition/consultations/open.html>]

ACCC Formal Merger Review Guidelines

- The ACCC released in May 2007 its Formal Merger Review Guidelines
- It gives details as to how the ACCC will process and respond to applications for formal clearance
- The update provides insight and guidance on the newly operational formal merger clearance process
- Detailed write-up has been circulated to participants
- The important aspect of the Guidelines is transparency

Need for a Merger Guidelines

- Indian business & other stakeholders too need Merger Guidelines
- It ensures confidence on both sides – the CCI and the stakeholders
- Merger Guidelines gives predictability to the Commission's ability to assess & analyze merger
- It is an effects-based approach

Business friendly-data

- Mergers under the Competition or Anti-trust laws are mostly allowed by authorities after investigations
- Some illustrations from the jurisdictions of Mexico, Brazil, Republic of South Africa and Australia are given to support the above statement

Mexico

- In 2005 the Mexican Competition Authority (CFC) :

✓ Reviewed	232 cases
✓ Allowed	220 cases
✓ Blocked	01 horizontal & 01 vertical
✓ Modified	06 horizontal & 01 vertical

- In 2005, CADE (Brazilian Competition Authority):

✓ Reviewed	497
✓ Not considered	111
✓ Considered	382
✓ Approved	345
✓ Approved with conditions	37

Republic of South Africa

- In 2005 – 06 the RSA Competition Commission:

✓ Received notifications	408
✓ Withdrawn due to lack of jurisdiction	08
✓ Accorded approval	394

Australia

- ACCC in 2006:

✓ Received	272
✓ Not opposed	261
✓ Opposed outright	03
✓ Resolved through undertakings	06

CC, UK decides OFWAT issue

- Competition Commission of the UK orders Price reduction following Water merger
- OFWAT is the Water Regulator of the UK and Wales
- The overlap issue between CC and OFWAT

CC – OFWAT issue (contd.)

- Under Water Industry Act, 1991 (as amended by the Enterprise Act. 2002) the OFT has a duty to make a reference to the CC if the OFT believes that a merger of two or more water enterprises has taken place or are in progress
- Jurisdiction: when turnover is > £10 million
- Q – 1: whether a Water merger has taken place;
- Q – 2 : if so, whether the merger has prejudiced, or may be expected to prejudice, the ability of OFWAT in carrying out its functions by virtue of Water Industry Act, to make a comparison between different water enterprises

CC – OFWAT issue

South East Water & Mid Kent Water

The CC has concluded that the merger between the two may be expected to prejudice the OFWAT's ability to make comparisons between water enterprises but the extent of the prejudice is limited. As a result, OFWAT may be expected to set less challenging targets for the water companies it regulates, which is likely to lead higher prices for customers. After considering a number of options, the CC decided that a price cut was the best solution. A price cut mitigates the adverse consequences of the merger, whilst allowing customers to benefit from the cost saving and the improved water resource management that the CC thinks are likely to result from the merger.

Lessons from the CC – OFWAT issue

- The Competition Act of India defines – ‘enterprise’, ‘person’ and ‘statutory authority’
- Municipal Corporations, Co-operative Societies, Local Authorities, Any authority, Board, Council, University any other body corporate, established by or under Central or Provincial statutes come within the ambit of the Law
- Section 21 provides for the mechanism to deal with overlap issues

Caveat

- Today's mergers can be tomorrow's dominance
- Dominance is not bad in Competition Law but its abuse surely is
- The merged entity should therefore be advised to remain 'competition compliant' throughout its business life so as to avoid the Competition Lens
- CA is likely to be amended and some provisions relating to Mergers may undergo certain changes
- Forum Shopping?– Companies Act, SEBI Act & the Competition Act – provisions are mutually exclusive

Caveat (contd.)

- Government departments – both Union and States and their statutory bodies come within the ambit of this Law
- They can sue any respondent private or public for breach of any provision of this Law before the CCI
- Identically they too can be sued by others
- Sovereign functions and Atomic Energy, Defence, Space Research and Currency exempted

Caveat (contd.)

- CCI too needs suitable professional manpower to implement the law in letter and spirit
- Overseas Competition Authorities' manpower planning and training programmes are good illustrations
- Turnover in manpower is tremendous even in transition economies – a challenge to CCI
- Professional & Academic Institutions must include the subject in academic curricula so as to provide the future professional manpower to the stakeholders
- Government to have robust Competition Policy that can be enforced under the CA by the CCI

International links

- OECD
- International Competition Network
- UNCTAD
- World Bank Institute
- International Bar Council
- Global Competition Forum
- European Commission
- Department of Justice and Federal Trade Commission
- Competition Commission of India

Lighter side

- **Mergers** are like solemnization of a valid marriage where the parties to the marriage have unanimity of interest and the **priest** performs the regulatory functions. Consolidation of two families. Growth ensured.
- But when the marriages fail, Courts to decide the conflicting interests between parties.
- The role of the Competition Authority is combination of a priest – ‘the regulator’ and that of a ‘judge’ – the adjudicator.

Thank you

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