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Research Article

ARTICLE TOPIC MERGERS OF ENTERPRISES AND THEIR EFFECTS ON COMPETITION LAW

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Abstract-This paper aims to give a more in depth knowledge about mergers of enterprises and the impact they have to competition law.

The topic provides a detailed explanation of the effects and their classifications that may affect geographic markets as well as other competing businesses in the market.

The question that inevitably arises is:

Do mergers positively affect competition law and the market? How much effectiveness does a merger of enterprises bring to the market and can it be justified by certain means or forms? These questions are answered based on the jurisprudence of the European Court of Justice *(case law).*

The paper ends up with conclusions in order to further improve the European legislation and the work of the competition authorities about mergers cases and their effectiveness in the market, having a direct impact on the well being of final consumer.

Keywords- Enterprise, Competition, European Union, Market, Consumer, Legislation.

I. INTRODUCTION

Merger of enterprises as a notion includes two separate enterprises that merge entirely into a new entity with a common purpose. The term 'merger' as used in competition policy covers a much wider range of business transactions.

For example, when enterprise A buys all or most of enterprise B's stock, this is considered a merger if A is able to control B's strategic business decisions. Even the purchase of a minority of shares may be sufficient, in

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certain circumstances, to qualify as a merger. The question that arises is whether A will gain the 'opportunity to exercise decision-making influence' over B.

The acquisition of assets, for example the acquisition of a well-known brand name, may result in a merger [2]. Two or more enterprises which merge parts of their businesses into a newly created new enterprise may be parties to a merger. In any event, the essential question is whether the first independent undertakings that are or will be under common control will, in the future, cause the market to operate in a less competitive manner than it did before the merger, or the opposite.

II. HORIZONTAL, VERTICAL AND CONGLOMERATE CONSEQUENCES OF MERGERS

Competition law has the aim to resolve the issue regarding the possibility that a merger will make the market less competitive in the future than it is currently, bringing negative consequences for consumers. The main concern of competition authorities when evaluating a merger is whether it will have negative *horizontal consequences* . There may also be concerns about *vertical* and *conglomerate consequences* , but these are very rare. It is possible that the same case can bring horizontal, vertical and conglomerate consequences [3]together.

2.1 Horizontal Consequences

Horizontal consequences occur when a merger occurs between actual or potential competitors in the same product and geographic markets and at the same level of the production or distribution cycle. In general, the horizontal consequences of mergers present a much greater risk to competition than the vertical consequences (or conglomerates), and horizontal agreements are treated more than vertical agreements. Horizontal mergers can be examined both for their 'unilateral' or 'non-coordinated' and for their 'coordinated' consequences.

2.2 Vertical Consequences

Vertical consequences occur when a merger occurs between enterprises operating at different, but complementary, levels of the market for the same final product. For example, company A may produce a raw material for a product produced by company B. Often such mergers, in terms of economic efficiency, flourish or are neutral, but there is a possibility that vertical integration may have a detrimental effect on competition, or because it creates a market risk by excluding third parties or because it may lead to collusion between the merged entity and third parties.

2.3 Conglomerate Consequences

There have been some cases in which competition authorities have had concerns about mergers having conglomerate effects rather than those having horizontal or vertical effects. For example a merger between A and B which are neither horizontal competitors, nor vertically functionally related, may enable the merged entity AB to exercise its market power in two markets related, but also unrelated, in order to exclude other competitors. Whether or not conglomerate mergers should be controlled is still a debatable issue.

[2] See eg Case M 890 *Blokker/Toys 'R' Us* , decision of 26 July 1997, OJ [1998] L 316/1.
[3] See Decision of the European Commission in case M 2220, *General Electric/Honeywell* , decision of 3 July 2001, OJ [2004] L 48/
See Case T- 210/01 *General Electric v Commission* [2005] ECR II- 5575, [2006] 4 CMLR 686.

The European Commission has expressed concern about the 'portfolio' or 'range' or 'conglomerates' effects of mergers on various occasions, on conglomerates in the *Tetra Laval / Sidel cases* [4]and at *General Electric / Honeywell International* [5].

III. MERGER ACTIVITY

In the enterprise world there are frequent short bursts of 'merger mania'. This happens when the level of union activity is very high [6]. For example, there was a very high rate of merger activity in the second half of the 1980s [7], and again in the mid-1990s [8]. Another activity began in 2005 and continued until 2007, this happened because private equity companies became increasingly involved in acquisitions of established companies. In a speech in June 2007 Commissioner Kroes spoke of a 'tsunami' of mergers which he welcomed as it involved the cross-border restructuring of markets in many sectors ranging from the energy sector to air transport to the telecommunications sector [9]. The financial crisis in 2008 significantly reduced merger activity in the following years.

A notable feature of mergers in recent years has been their increasing complexity, size and geographic reach. Very large mergers have occurred in many sectors as companies have sought to restructure and consolidate their place in an increasingly global market. For example, in the pharmaceutical industry Pfizer and Warner-Lambert merged to become the largest pharmaceutical company in the world [10]. Major mergers have occurred in the car industry, for example between Daimler-Benz and Chrysler [11], between Ford and Volvo [12], between Renault and Nissan [13].

IV. WHY DO ENTERPRISES MERGER TOGETHER?[14]

There are many reasons why enterprises merge, most of which are beneficial, or at least not harmful to the economy, but there are other reasons that are more problematic.

4.1 Economies Of Scale And Scope

One of the reasons for some mergers is to achieve economies of scale and scope. A company will produce goods at the lowest marginal cost when it is able to operate at the minimum efficient scale. Economies of scale may be *product-specific*, when they enable a product to be produced more cheaply. These economies may be *specific on a factory basis*, where the overall use of a factory producing many products is made more rational. Or they can *be specific on a company basis*, where they generally result in a lower cost. The globalization of markets in recent years, as tariffs and other trade barriers have been reduced and as rapid technological change has changed the nature and structure of markets, has enabled companies to expand into large geographic

[4] Case M 2416 *Tetra Laval/Sidel* , decision of 30 October 2001, OJ [2004] L 43/13.
[5] See Case M 2220, *General Electric/Honeywell* decision of 3 July 2001, OJ [2004] L 48/1.
[6] See Scherer and Ross *Industrial Market Structure and Economic Performance* (Houghton Mifflin, 3rd [ed], 1990), p. 153–159.
[7] See 1986 *Annual Report of the Director General of Fair Trading* , p. 27–28.
[8] See 1995 *Annual Report of the Director General of Fair Trading* , p. 13.
[9]Speech by Neelie Kroes speech of 5 July 2007, available at www.ec.europa.eu/competition/speeches.
[10] Case M 1878, decision of 22 May 2000.
[11] Case M 1204, decision of 22 July 1998.
[12] Case M 1452, decision of March 26, 1999.
[13] Case M 1519, decision of May 12, 1999.
[14] See Scherer dhe Ross *Industrial Market Structure and Economic Performance* (Houghton Mifflin, 3rd ed, 1990), f. 159–167; Andrade, Mitchell dhe Stafford 'New Evidence and Perspectives on Mergers' (2001) 15(2) Journal of Economic Perspectives 103.

markets. It may be that a company achieves economies of scale through internal growth. Also, it is possible that this can be achieved more easily by external growth, which means through mergers with other companies.

While economies of scale arise from more or less the same activity, economies of scope are concerned with the economic benefits generated by related activities. An obvious example would be the reduction of general administrative expenses through the operation of different production lines.

Whether the mergers actually lead to the economies of scale and scope expected of them is another matter. Some argue that in practice the predicted profits are simply an illusion [15].

4.2 Other Efficiencies

In addition to economies of scale and scope, mergers can lead to efficiencies in other ways. For example, it may be cheaper to buy a distribution network than to set up from scratch on a contractual basis. A merger means that a company will have improved access to credit and equity capital than when operating alone. A merger can make a company able to carry out the process of research and development and this a greater approach to industrial technology consortia. Another possibility is that a merged enterprise may be able to make better use of the management capabilities of its constituent parts.

4.3 Management Efficiency And The Corporate Control Market

One explanation for some mergers is that one enterprise competes with another. A successful takeover attempt acts as a significant influence on the existing management of an enterprise to ensure that it operates as efficiently as possible. When shareholders are satisfied with the work of the current management they will not sell their shares to another bidder unless there is a higher offer. If the shareholders are unhappy, they may prefer to sell the shares at the offered price and invest the proceeds elsewhere, so it is likely that the old management will be replaced by the bidder. According to this argument the 'market for corporate control' is an important element in promoting economic efficiency [16].

4.4 Existence In The Industry

Mergers allow companies to exit in an industry. In a free market it is important to encourage entrepreneurs to invest their money and skills in setting up new businesses and entering new markets. Just as it is desirable to prevent the barriers to entry and expansion that prevent new companies from competing in the market, so it is necessary to avoid exit barriers that make it difficult for a company to leave a market. . The incentive to set up a company, invest capital and develop new products may be reduced if it is not possible to sell the company in question as a result of a valuable concern. It is common, for example, for companies to acquire small enterprises that possess technical know-how or that have intellectual property rights and, from the perspective of an

[15] Scherer dhe Ross *Industrial Market Structure and Economic Performance* (Houghton Mifflin, 3rd ed, 1990), f. 167–174; Meeks *Disappointing Marriage: A Study of the Gains from Merger* (Cambridge University Press, 1977); Monti 'Review of the EC Merger Regulation—Roadmap for the Reform Project' 4 June 2002, at www.europa.eu/competition/speeches, and the empirical studies referred to therein; Roller, Stennek dhe Verboven 'Efficiency Gains from Mergers', The Research Institute of Industrial Economics, Working Paper 543 (2000), www.ec.europa.eu/competition/speeches .

[16] Manne'Mergers and the Market for Corporate Control' (1965) 73 Journal of Political Economy 110; Easterbrook and Fischel 'The Proper Role of a Target's Management in Responding to a Tender Offer' (1981) 94 Harvard Law Review 1161; Coffee 'Regulating the Market for Corporate Control: a Critical Assessment of the Tender Offer's Role in Corporate Governance' (1984) 84 Columbia Law Review 1145; Rock 'Antitrust and the Market for Corporate Control' (1989) 77 California Law Review 1367; Bradley'Corporate Control: Markets and Rules' (1990) 53 MLR 170; Wright, Wong and Thompson 'The Market for Corporate Control: an Economic Perspective' Miller (ed) *The Monopolies and Mergers Yearbook* (Blackwell Business, 1992), 32–42.

innovator of such technologies, the freedom to sell can be an important element as a reward for the risks taken. A strict approach to the merger could have an undesirable consequence if exit procedures were made too difficult.

4.5 Increasing Market Power

The real reason why companies want to merge is that this will eliminate competition between them, increase their market power, and allow them to limit production and raise prices.

Competition authorities constantly request copies of documents of enterprises (of internal and external advisers), which determine the business reason for a certain transaction. The merger control systems in place in the European Union, the United Kingdom and elsewhere appear to prevent cases in which companies seek to achieve market power, but it is important to bear in mind that, in the absence of a merger control system, enterprises will be able to act in this way.

V. WHAT IS THE PURPOSE OF MERGER CONTROL?

There are many reasons why governments, companies, shareholders, and individuals may oppose mergers. A government can oppose a merger for a number of reasons. For example, it may not agree to a foreign company merging with a domestic one, or it may not approve a merger that does not fit its industrial policy, or a transaction that will lead to unemployment. A company may object to be subject of an auction, or a merger between two rivals that could give them a competitive advantage.

Shareholders (legal entities or natural persons) may be concerned if corporate transactions will have a negative effect on the value or effectiveness of their shares. Competition policies and competition authorities are primarily concerned with maintaining the process of competition in the market, not as an end in itself, but as a way to maximize consumer welfare.

Some merger control systems allow broader 'public interest' criteria to be taken into account in relation to the overall merger assessment. However, most competition authorities are concerned with only one issue, namely the assessment of the competitive consequences of mergers.

VI. IS MERGER CONTROL NECESSARY?

Competition law prohibits the abuse of market power: Article 102 of the TFEU is a clear example of this. The question naturally arises: Why should there be a power to prevent the creation or strengthening of market power before it occurs ('*ex ante control'*) given that there are legal controls to prevent the abuse of market power when it happens (' *ex post control* '). One answer to this is that merger control is not simply about preventing future abuses, it is also about maintaining competitive market structures that lead to better outcomes for consumers [17]. Another is that investigations under Article 102 (and their domestic equivalents) are long, complex and burdensome, and that competition authorities do not have the resources to monitor every alleged infringement. The exclusive use of Article 102 will not be effective.

[17] Case T-102/96 *Gencor v Commission* [1999] ECR II- 753, [1999] 4 CMLR 971, p 106.

A competition authority investigates and assesses whether a merger will have harmful consequences for competition in the future [18]. Most mergers must be notified to the competition authority and 'cleared' before they become effective. Even in those few jurisdictions, such as the United Kingdom and Australia, where a merger can be implemented prior to competition authority approval, because there is no prior notification obligation, the assessment is still essentially about predicting future consequences of market power. The foreseeability of merger control is different from the assessment of agreements and practices under Articles 101 and 102 of the TFEU.

A competition authority deciding to challenge a merger must be based on a *theory of competitive harm* which supports the argument that the market will work worse for consumers in the future than it does now. However, it would not be acceptable for an authority to oppose a merger merely on the basis of theory. There is nothing illegal about merger activity, and the market for corporate control, in which companies compete to win the right to take over and manage businesses. This is an important feature of a free market economy. Intervention by public authorities should not be allowed based on mere speculation. The competition authority must present *evidence* supporting its theory of competitive harm. In addition, the competition authority must prove that the market, after the merger, will be less competitive compared to the time when this merger did not exist. In other words, the authority will not only have to foresee the possible outcome of the merger, but also to consider *the opposite*, which means the case when the merger would not have happened.

VII. THEORIES OF COMPETITIVE HARM

Most mergers do not cause any competitive harm. However, there may be cases where it is foreseeable that the changed market structure will enable the merged entity to exercise market power in a manner that will affect consumer welfare. A competition authority concerned about a particular merger which will infringe competition.

There are a number of different theories of infringement of competition law which are examined below.

7.1 Unilateral Or Uncoordinated Consequences[19]

Unilateral effects occur when A merges with B and the merged entity, AB, will be able, as a result of the merger, to exercise market power. The most obvious manifestation of the exercise of market power is the ability to raise the price, but there are other possibilities such as a reduction in production, quality, variety or innovation. "Rising prices" would be the appropriate term that encompasses all these various manifestations of the exercise of market power. The ability to exercise market power is particularly likely if, prior to the merger, a price increased by A would have the potential to 'shift' a significant number of customers to B. AB merged enterprise will not lose any profits as a result of such merger, as AB will benefit from increased sales of B's products.

[18] Case C-12/03 P *Commission v Tetra Laval BV* [2005] ECR I- 987, [2005] 4 CMLR 573, at para 42:' An analysis needed for merger control should be performed with great care as it does not involve consideration of past events. . . or of current events, but includes a prediction of events which are more or less likely to occur in the future, unless a decision prohibiting the planned concentration or setting conditions is implemented.'

[19] See *Workbook* , Worksheet C; unilateral consequences are sometimes also known as uncoordinated consequences, to distinguish them from the coordinated consequences discussed in the next section.

It may be that after the merger, C, a competitor of AB, will be able to exercise market power because, if AB were to raise its prices, some consumers would be diverted to C, which can also raise prices itself. C may be able to do this without coordinating its behavior with that of AB, in which case C's behavior itself may be characterized as unilateral or uncoordinated. This phenomenon is also known as 'non-hidden oligopoly' [20].

7.2 Coordinated Consequences[21]

Coordinated consequences occur when A joins B and this results in a situation where AB will be able, or better than when A and B were independent, to coordinate their competitive behavior in the market with other companies, such as C and D, and thus exercise collective market power. First, AB, C, and D must coordinate their behavior in some way, for example by setting the same prices or, perhaps, by coordinating their behavior regarding production and capacity expansion. Second, it must be costly for them to deviate from coordination, for example, because they would be punished for 'speculation'. Third, AB, C and D should not have competitive restrictions from other participants and players in the market.

7.3 Vertical Consequences[22]

It is generally unlikely that a merger will have negative vertical consequences. However a merger between an upstream company, A, and a downstream company, B, is likely to be neutral in terms of economic efficiency as well as highly beneficial. For example, if A and B are independent each will have to earn a margin in its operation, perhaps where A is the manufacturer and B the distributor. However, there may be circumstances in which a vertical merger may bring negative consequences, firstly, when the possibility of exclusion of a third party arises , secondly, where the vertical integration of AB brings coordinated consequences in the market.

7.4 Conglomerate Consequences[23]

In general, conglomerate mergers are not likely to cause negative competitive consequences. They do not result in the exclusion of actual or potential competitors from the market, as in the case of horizontal mergers, nor do merge enterprises that have a vertical relationship with respect to the same final product, where there may be incentives to exclude competitors from the downstream market upper or lower. Moreover, as in the case of vertical mergers, conglomerate mergers often result in efficiency gains, for example when the merged entity AB is able to offer complementary products that do not compete with each other to a customer who wants both.. If A produces product H and B produces product G, a 'one-stop shop' can be very useful for a customer looking for both products. The theory of harm in the case of conglomerate effects is particularly speculative, for example where the CA may decide to 'bundle' two complementary products together in a way that will foreclose competitors, or price a bundle for having a similar consequence. It is possible that merger transactions and bundling practices would violate laws prohibiting abuse of a dominant position or, in the case of US law,

[20]On dealing with oligopoly that does not constitute collusion see US Case *FTC v HJ Heinz Company and Milnot Corpn* 246 F 3d 708 (DC Cir 2001).
[21] See *Workbook* , Worksheet D.
[22] Ibid., Worksheet H.
[23]; See also OECD *Portfolio Eff ects in Conglomerate Mergers* (2002), available at www.oecd.org.

monopolization, although the law on this matter is itself controversial. Intervention on conglomerate facts is possible under EU and UK law, but would require very convincing evidence in support of the theory.

The European Court of Justice has made it clear that, when a merger is challenged on a conglomerate basis, the evidence on which the Commission relies must be particularly convincing, given that the chains of cause and effect between the merger and the anticipated negative consequences are unclear, uncertain and difficult to establish.

VIII. GUIDELINES FOR MERGERS

There are many guidelines regarding the material valuation of the merger. I have already mentioned it based on the *Merger Guidelines Workbook* of the ICN and *the Manual of Investigative Techniques* [24]. Many competition authorities have published guidance on material assessment. Of particular importance *are the 2010 Horizontal Merger Guidelines* in the US [25]and the joint guidelines of the Competition Commission and the OFT in the United Kingdom [26]. The European Commission has published *Guidelines for the Evaluation of Horizontal Mergers* [27]and *the Evaluation of Non-Horizontal Mergers* [28]. The guidelines should strike an appropriate balance between providing guidance to undertakings and their advisers on what can be expected from a merger control system and avoiding too much speculation on the other hand, which could lead to a loss of safe.

A specific problem in merger control systems is whether to allow a merger that reduces competition but in turn increases efficiency. The US guidelines deal with this issue specifically and in very limited circumstances, recognize the efficacy argument [29]. Part 30 of the UK Enterprises Act 2002 allows the Competition Commission to take into account 'relevant consumer benefits' in certain circumstances. While the European Commission's *Horizontal Guidelines* take efficiency into account based on the overall assessment of a merger. Another issue that sometimes arises is whether a merger should be allowed to save a 'bankrupt company', even though there will be less competition in the market after the merger than before. In American law there is a strong protection for the bankrupt company.

IX. CONCLUSIONS

Frequently most aspects of a particular merger do not raise any competition concerns. However, it may happen, for example, where there are parts of companies A and B that are horizontally mergered, and in this case a competition authority, instead of stopping the whole transaction, can find a solution that does not harm competition and therefore the rest of the agreement is allowed to continue.

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[24]The ICN has also published 'Recommended Practices' on matters such as settlements, notices and merger procedures; these are all available at www.internationalcompetitionnetwork.org.

[25] These are available at www.justice.gov.atr/public/guidelines, for which see Shaprio ' The 2010 Horizontal Merger Guidelines: From Hedgehog to Fox in Forty Years' (2010) 77 Antitrust Law Journal 701.

[26] *Merger Assessment Guidelines* , CC2 (revised) and OFT 1254, September 2010, available at www.oft .gov.uk.

[27] OJ [2004] C 31/5.

[28] OJ [2008] C 265/6.

[29]The complexity of efficiency allowed as a defense in a merger case is illustrated by *the Superior Propane* Case in Canada: See *The Commissioner of Competition v Superior Propane Inc* [2003] 3 FC 529, judgment of 31 January 2003 (Federal Court of Appeal), available at www.fca-caf.gc.ca/index_e.shtml; See also European Commission's (2003) (Summer) *Competition Policy Newsletter* 43–49; Williamson' Economies as an Antitrust Defense: The Welfare Trade-off ' (1968) 58 American Economic Review 158; Kolasky and Dick 'The Merger Guidelines and the Integration of Efficiencies into Antitrust Review of Horizontal Mergers' (2003) 71 Antitrust Law Journal 207; Gerard 'Merger Control Policy: How to Give Meaningful Consideration to Efficiency Claims?' (2003) 40 CML Rev 1367.

The most obvious solution is substantial diversification of one business or the other so that there is no uncontrolled growth of market power. Some cases may require more complex solutions, for example the right of access to an essential facility or the licensing of technology to competitors on reasonable and non-discriminatory terms. Designing and implementing satisfactory solutions is often a complex matter. The OECD published *Merger Solutions* in 2004, which followed round tables in which a series of recommendations for good practice were drawn up [30]. In 2005, the ICN published *the Merger Remedies Review Project* [31]which is a practical guide to the main principles and range of tools available for creating appropriate remedies.

An important issue remains that the standard of proof to be set by a competition authority must be established before measures can be taken to block or modify a merger.

Must the competition authority find that a merger will be harmful to competition after making a 'balance of probabilities', or must it go further and show 'beyond reasonable doubt' that the merger will have harmful consequences ? If the competition authority can intervene too easily, on the basis of non strong evidences, there is the possibility that 'false positives' may arise, meaning that some harmless mergers may be blocked. However, if the criteria for interference are too demanding, or if the standard of proof is set at too high level, 'false negatives' may also occur and thus some harmful mergers would not be stopped [32].

To be realistic, it is inevitable that some mistakes of both kinds will be made by competition authorities. However, this remains a matter of the competition policies of each country or of different legal systems to examine and decide which are the most optimal solutions in order to protect the final consumer.

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[32] These,l/.are also known as Type I and Type II errors: See Black *Oxford Dictionary of Economics* (Oxford University Press, 3rd ed, 2003),

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