Horizontals revisited – EU Merger Control in 2010

By

Andreas Weitbrecht

Reprinted from ECLR
Issue 3, 2011

Sweet & Maxwell
100 Avenue Road
Swiss Cottage
London
NW3 3PF
(Law Publishers)
Horizontals revisited—EU merger control in 2010

Andreas Weitbrecht
Partner at the Brussels and Frankfurt offices of Latham & Watkins LLP; Honorary professor at the University of Trier

† Competition policy; Economic conditions; EU law; European Commission; Horizontal mergers; Investigations; Merger control; References; Remedies

Following the economic crisis of 2008/2009, the year 2010 brought a return to “business as usual” in European merger control. Classical horizontal mergers were at the heart of the Commission’s practice. In addition, the General Court confirmed the Commission’s only prohibition over the past five years—the proposed merger between Ryanair and Aer Lingus. Referrals of mergers between Member States and Commission were beginning to reveal creaks in the functioning of the system. This article will concentrate on the most significant developments.

Commission jurisdiction and procedure

The end of the economic crisis during the year 2010 has not yet led to a significant increase in the number of mergers notified. The figure for 2010 came out only slightly higher than for 2009. At the same time, one can notice a more active management of the referral mechanisms between national authorities and the Commission pursuant to arts 9 and 22 ECMR.†

Statistics

In 2010 the Commission received a total of 274 notifications, compared to 402 notifications in the record year of 2007.‡ As regards referrals, the total number of referrals made in each category is probably too low to allow for statistically valid comparisons on a year-to-year basis. But it is perhaps notable that during 2010, there were 11 requests by Member States for a referral of a merger from the Commission to Member States, compared to three such requests in 2009 and an average of five such requests during the past five years. Fourteen mergers were authorised during the first phase with commitments during the first 10 months of 2010, which is slightly above average. Only three cases were put into phase II during the reporting period, which is a relatively low number by historical standards, reflecting the tendency to treat even difficult mergers in phase I. The percentage of mergers that were treated under the simplified procedure continuous to decline, with slightly more than 50 per cent of all mergers cleared in phase I without commitments being treated under the simplified procedure.

Referrals between Member States and Commission pursuant to articles 9 and 22 ECMR—creaks in the operation of the referral system

During last 12 months, three significant cases were referred by Member States to the Commission pursuant to art.22 ECMR.‡ This provision, at the time called the “Dutch clause”, was originally conceived to allow Member States that did not (yet) have their own system of merger control to secure effective review of mergers


‡ The proposed joint venture between BHP and Rio Tinto Zinc would have combined the two parties’ iron ore mining and production activities and assets in Western Australia, while each parent would have continued to market on its own the iron ore produced by the joint-venture, which predominantly goes to South East Asia. The two parties are, together with the Brazilian company Vale, the three largest producers of iron ore in the world. The production joint venture did not constitute a full function joint venture and was therefore treated by the Commission under art.101 TFEU. At the same time, national competition authorities in a number of countries reviewed the transaction under their merger control laws. Ultimately, the transaction was abandoned over regulatory opposition in many countries fuelled by opposition from major customers in China, Japan, Korea and Taiwan.


* Decision of November 17, 2010 (COMP/M.5765—Syngenta/Monsanto’s Sunflower Seed Business); Decision of November 17, 2010 (COMP/M.5685—Unilever/Sara Lee Body Care; COMP/M.5830—Olympic/Agean Airlines), which was prohibited by the Commission on January 26, 2011.

** Decision of June 17, 2010 (COMP/M.5928—Procter & Gamble/Sara Lee Air Care); Decision of November 17, 2010 (COMP/M.5673—Syngenta/Monsanto’s Sunflower Seed Business; COMP/M.5969—SCJ/Sara Lee insecticides) which, following the introduction of remedies, has a provisional phase I deadline of December 22, 2010.
in their territory by referring these mergers to the European Commission. Now that all Member States have a national merger-control regime, the function of art.22 appears to be changing: it allows the Commission to review pan-European mergers that do not meet the turnover thresholds of the ECMR, provided the merger is referred to the Commission by a Member State.

However, these ad-hoc referrals are not without their issues. The acquisition by Procter & Gamble (“P&G”) of the air care business of Sara Lee was notified in 11 Member States and it would appear that the criticism of forum shopping coming out of the Commission was also directed at P&G for failing to request a referral of that merger to the Commission by introducing a Form RS. The case might have resulted in a jurisdictional nightmare as five Member States referred the merger to the Commission while the other six cleared the merger on their own. Ultimately diverging decisions among the Commission and NCAs were avoided in that the merger was cleared without any remedies in all jurisdictions, but this case certainly shows that the current system of flexible referrals, only recently praised by the Commission in its Report on the Functioning of the ECMR, is far from perfect.

Secondly, it is not clear whether the Commission, acting upon a referral pursuant to art.22, can review and remedy competitive issues arising in Member States other than those that requested the referral. While the wording of art.22 does not suggest such a limitation, the Commission, in its clearance decision in P&G/Sara Lee Air Care restricted itself to reviewing the national markets in those Member States that had made a referral request.

Finally, these referrals, whether pursuant to art.22 or pursuant to art.9 from the Commission to a Member State, mean a loss of time and predictability, subjecting companies to a change in the applicable procedural and substantive law even though the purpose of the referrals supposedly is merely to ensure that the merger will be reviewed by the authority that is best placed to do this—a flexible standard which sometimes renders unpredictable results. The next revision of the ECMR will certainly need to tackle these issues in a way that is both conceptually coherent and workable in practice.

**Mergers involving consumer goods—a field day for economists**

According to well-established antitrust learning, any competition analysis begins with defining the relevant market. This conventional wisdom is increasingly coming under fire from economists who for quite some time have argued that the competitive relationship between two products can be analysed directly without having to resort to a market definition which includes additional products in the analysis. Indeed, in reality, the competitive relationships between certain products often are more properly viewed as a continuum rather than described as a world of black and white where products are either fully substitutable or not substitutable at all. A similar situation exists with respect to the definition of the geographic market as many of today’s markets, still predominantly national, are on the verge of becoming EEA-wide.

This methodology has been highlighted by recent cases in the consumer goods industry. The richness of economic data available from consumer surveys such as Nielsen allows for the liberal use of econometrics that are usually much more difficult to apply in other industries for lack of data. Econometric studies are usually conducted in two phases: first, the effect of the merger on demand (elasticities) is estimated; and, in a second stage, the estimates of the elasticities of demand become input into a merger simulation model. The merger simulation model then predicts the size of a likely price increase post merger.

**Kraft Foods/Cadbury—close and not-so-close competitors in chocolates**

On January 6, 2010, the Commission cleared in phase I the proposed acquisition of Cadbury by Kraft by way of a public offer, subject to the divestment of Cadbury’s Polish and Romanian chocolate businesses. Given that various brands of the parties enjoyed vastly diverging popularity among the Member States and in line with the general approach to consumer goods markets, the Commission defined the markets as national. The product markets were defined as chocolate confectionary, which included separate market segments such as tablets and pralinés. Obviously, Kraft, with its extremely strong brands of Milka, Côte d’Or and Toblerone, enjoyed a strong position in continental Europe whereas its position...
in the United Kingdom was weak. Conversely, Cadbury had a very large and well-established position in the United Kingdom and Ireland. The Commission ultimately required divestments in national markets (Poland and Romania) where the combined market share of Kraft and Cadbury would have reached 60–70 per cent, and where Cadbury’s local heritage brands were found to compete closely with Kraft’s Europe-wide brands.

Similar combined market shares were reached in the United Kingdom and Ireland. Nevertheless, the Commission did not require divestitures. This decision based on the fact that Cadbury’s brands and Kraft’s brands, while combined leading to very high market shares, do not significantly compete with each other, i.e. they are not very close competitors. This is particularly true for Kraft’s Toiberone brand, which is classified as a tablet but which, due to its shape and taste, is clearly not a very close competitor to conventional tablets championed by Cadbury. In further support of the contention that the Cadbury and Kraft brands are not very close competitors, the parties carried out a merger simulation by way of econometrics and upon testing the robustness of the results the Commission was satisfied that the merger was unlikely to lead to significant price increases in the United Kingdom and Ireland.13

**Unilever/Sara Lee Body Care—closely competing deodorants**

The Commission performed a similar analysis when reviewing the acquisition by Unilever of Sara Lee’s body care business.14 Unilever has a particularly strong position with a range of deodorant brands such as Axe, Dove and Rexona, which are present across Europe. Sara Lee uses the Sanex brand for deodorants and other body care products such as soaps in a number of European countries. Supported by extensive econometric analysis, the Commission considered that the merger might give Unilever the ability to raise prices for deodorants in some of its existing brands as post-merger Sanex would no longer exert any competitive pressure on Unilever’s close substitutes Dove and Rexona. The merger therefore raised serious competition concerns in a number of Member States and was authorised only subject to the divestiture of Sanex.15

**IT and telecommunications industries**

In an industry as complex and vertically integrated as the IT and telecommunications industries, the usual categories of horizontal/vertical/conglomerate relationships are not always appropriate. Nevertheless, the mergers dealt with in 2010 presented primarily horizontal issues.

**Oracle/Sun Microsystems**

The Commission’s unconditional clearance of the proposed acquisition by Oracle of Sun Microsystems following a contested phase II inquiry has been described in last year’s report.16 The Commission has been severely criticised for attaching significant weight to a public announcement by Oracle pledging support for the further development of the open source database software MySQL, while at the same time not insisting that this pledge be reduced to a binding commitment and precondition for clearance. The decision has been appealed by the founder of MySQL.17

**Orange UK/Deutsche Telekom UK**

The merger between the British mobile telecommunications subsidiary of France Telecom and Deutsche Telekom18 meant that in the United Kingdom the number of large mobile telecommunication providers with own infrastructure was being reduced from five to four, creating a new market leader with shares of 33 per cent in the end customer market and 49 per cent in the upstream market for network access. Faced with a referral request by the British OFT pursuant to art.9 ECMR and complaints from competitors and consumer organisations, the Commission worked very closely with the OFT in clearing the merger subject to commitments by the parties that ensure the continued access to infrastructure by the Maverick provider 3UK. In light of these commitments offered by the parties, the OFT withdrew its referral request.

**Mergers in the airline industry—new issues and familiar problems**

Perhaps more than any other industry, the global airline industry still is in need of consolidation as the system of national flag carriers, protected by restrictive air services agreements, is giving way to vigorous competition among various business models relatively free from regulatory restrictions. The Commission welcomes the breaking up of national monopolies and markets and recognises the benefits of consolidation. At the same time, given that

---

13 Kraft Foods/Cadbury Decision para.69. How large a predicted price increase needs to be to constitute a significant impediment to effective competition is, of course, an open issue. In Ryanair/Aer Lingus, a price decrease of 7–9% by Aer Lingus when Ryanair entered a particular route (prior to the merger) was considered significant.


15 For a discussion of the extent of the divestitures see the “Remedies” section of this article.


18 Decision of March 1, 2010 (COMP/M.5650—T-Mobile/Orange).
customers demand transportation between specific destinations, the necessary narrow market definition makes clearance often very difficult.

**British Airways/Iberia—what is the proper counterfactual?**

The merger between British Airways and Iberia led to substantial overlaps on routes between London Heathrow and major destinations in Spain where the merging parties reached market shares between 70 and 80 per cent. However, the Commission found that considerable competitive constraints were exerted over the merged entity by Easyjet and Ryanair even though they operate from other airports of the London airport system such as Gatwick, Stansted and City.

The second interesting feature of this merger is the fact that pre-merger there was already a close co-operation between the parties: as part of the One World alliance, the parties have for a considerable time co-ordinated inventory, pricing and yield management and this co-ordination had been exempted by the Commission in 2003 subject to slot undertakings. The Commission accepted that a continuation of the close co-operation between British Airways and Iberia was the proper counterfactual against which to evaluate the merger. As a result, the competitive effects of the merger were very limited and the merger was cleared without additional remedies.

**Olympic/Aegean—Ryanair/Aer Lingus revisited**

During the course of the year, the Commission opened a phase-II proceeding in order to analyse the proposed acquisition of Aegean by Olympic Airways, the Greek flight carrier. While Aegean is a much smaller airline than either Ryanair or Aer Lingus, the merger between the two largest Greek airlines presents some of the same issues that were at the core of Ryanair/Aer Lingus: the parties would jointly control 80 per cent of flights and 90 per cent of capacity on the Greek domestic market; and it was to devise remedies that would entice competitors to establish a hub in the south-eastern corner of the European Union and/or to compete with the merged entity on unattractive routes to the thinly populated Greek islands. The Commission prohibited the merger on January 26, 2011.

**Remedies—larger divestitures required**

The cases decided by the Commission during this year have also shed new light on the Commission’s evolving remedies policy. With respect to divestitures, the following tendencies can be identified:

**No splitting of brands within the European Union**

In the acquisition of Sara Lee’s body care business by Unilever, problems were identified only with respect to certain Member States, even though the Sanex brand is sold Europe-wide. However, the Commission required the divestment of the Sanex brand for deodorants for the entire European Union, because in the internal market it is not practical for different owners of the same brand within the European Union to compete on a long-term basis.

As a result, the divestiture of brands has to be Europe-wide. On the other hand, in Kraft Foods/Cadbury Decision, the brands to be divested were essentially used only in Poland and Romania respectively; thus, the economic effects of the divestiture were minor.

**Sufficiently large divestiture packages required**

Even in the absence of the particular issues resulting from the free movement of branded goods in the European Union many issues remain: where the divestiture package is a small and fragile carve-out from an existing business that the merging parties want to retain, where the number of potential buyers is extremely limited or where it is questionable that a business would fetch a suitable buyer at all, the Commission will often require that a buyer has to be presented upfront before the parties may close their merger.

Where the parties want to avoid the requirement of an up-front buyer, the Commission often requires a larger divestiture package, i.e. the inclusion of a sufficient number of products in a sufficient number of countries, going far beyond the mere elimination of the overlaps that are identified as competition concern. This policy was particularly evident in the Syngenta/Monsanto sunflower seed business merger, where brands were not an issue. Nevertheless, for certain products, the Commission required Syngenta to divest the entire EU business even though concerns were identified in only a limited number of countries; in order to ensure that the divested business was commercially viable, the

---

21 COMP/M.5830—Olympic/Aegean Airlines.
22 See Unilever/Sara Lee Body Care Decision.
23 In this connection, the Commission also rejected a rebranding solution whereby the purchaser of the brand would receive a license with respect to certain Member States for a limited period of time during which he undertakes to rebrand the products associated with the divested brand to another brand. The Commission considered that this sort of divestiture would over the time weaken the competition exerted by the divested brand.
24 Kraft Foods/Cadbury Decision.
25 The overall size of the business being acquired and of the relevant markets is very small and the merger, due to the very limited revenues of the assets being acquired escaped merger control in such notorious countries as Germany and Austria. However, due to the market shares of the entity, it was notified in Spain and also in Hungary. Decision of November 17, 2010 (COMP/M.5675—Syngenta/Monsanto’s Sunflower Seed Business).
Commission required even the business in Russia, Ukraine and Turkey to be included, the principal countries in which these seeds are sold.\textsuperscript{26}

In some cases, parties will also choose to divest a larger business than may be strictly required by the Commission in order to create a more attractive package from the perspective of potential buyers.

**Judicial review**

Judicial review of Commission merger decisions has become a regular feature of EU merger control. Apart from the two judgments reported below, which have become final, the General Court also confirmed the Commission’s clearance subject to commitments of the acquisition by Lagardère of the French language publishing activities of Vivendi Universal.\textsuperscript{27}

**Ryanair/Aer Lingus—confirmation of Commission prohibition**

The General Court confirmed the Commission’s prohibition\textsuperscript{29} of the proposed acquisition by Ryanair of the former Irish national flag carrier Aer Lingus.\textsuperscript{28} Anyone reading the Commission’s carefully reasoned prohibition decision must conclude that if there ever was going to be a prohibition of a merger, this merger was a prime candidate. The particular feature of the case—and determinative of its outcome—is the fact that suitable remedies were not available: the usual remedies such as release of slots are not practical where no other airline would want to establish a hub in Dublin at the outer western end of Europe, or make Dublin a destination served from many European cities, and all of that in competition to the powerful merged entity.

In response to a challenge by Ryanair, the General Court also dealt with the econometric studies introduced in the Commission proceeding, in particular the fixed-effects regression analysis conducted by the Commission to measure the effect on prices of the entry of one of the parties on a route previously served by only one of the parties. The Court reviewed the study’s methodology and results, noting that the study corroborated the qualitative evidence according to which despite their differing business models the two parties were relatively close competitors. Therefore, the Commission was entitled to rely on it as further evidence in support of its conclusion that significant competition would be lost as a result of the merger. The Court’s careful analysis of this study may somewhat allay the concerns of observers, also voiced in last year’s report,\textsuperscript{30} that the increased use of economic and econometric models would further widen the sphere where the Commission enjoys a discretion that is largely immune from legal challenge because it involves complex analyses of an economic nature.

**Aer Lingus/Commission—Ryanair may keep its minority shareholding**

Following the Commission’s prohibition of the merger between Ryanair and Aer Lingus in 2007, Ryanair retained a share of 29.4 per cent in Aer Lingus. As the Irish Government and two pension funds also held substantial shareholdings, the shareholding by Ryanair did not confer control over Aer Lingus. Nevertheless, Aer Lingus was of the view that the Commission, when ordering Ryanair to divest its controlling shareholding in Aer Lingus based on art.8(4) ECMR should have ordered a complete divestiture of all shareholdings, which the Commission refused to do. Aer Lingus appealed to the General Court and, as expected, the General Court dismissed the application by Aer Lingus.\textsuperscript{31} This compelling result was reached on the basis that the acquisition of a non-controlling shareholding does not constitute a merger under the ECMR and therefore does not trigger any competence on the part of the Commission to intervene on the basis of the ECMR.

**Outlook and trends**

The trends identified at the conclusion of the report covering 2008 and 2009 continue to be in alive: the tendency to clear complex cases in phase I has certainly become even more prevalent. Likewise, economics and econometrics have continued to gain in importance and the way in which the General Court in the Ryanair/Aer Lingus Decision treated the econometric studies introduced in the Commission proceeding may contribute to such studies becoming more and more standard. Beyond these continuing trends, two more developments can be identified.

**Creaks and cracks in the one-stop shopping model**

The referral of mergers upward and downward among competition authorities seemingly at will and without regard for the expectations of the parties is likely to come into focus as agencies battle for the opportunity to review

---

\textsuperscript{26} While the jurisdiction of the EU does not extend beyond the territory of the EU, the voluntary nature of commitments (at least as a concept) allows the Commission to extend commitments to include businesses outside the confines of the EU, as long as this divestment is necessary to fix a problem on a market located within the EU.

\textsuperscript{27} Editions Odile Jacob v Commission of the European Communities (T-279/04) Unreported September 13, 2010. In this context, the General Court also looked at a warehousing structure which had been used by Lagardère in order to take the assets out of the hands of Vivendi Universal, which wanted to complete the sale very quickly. Under this structure Lagardère paid the purchase price to Vivendi Universal long before even notifying the transaction to the Commission, assuming the entire economic risk of the transaction while parking the shares with a bank that benefited from the exception of art.5(3)(a) ECMR for financial institutions. The Commission had accepted this structure and not seen an infringement of the stand-still obligation of art.7(1) ECMR. The General Court ultimately did not reach a decision on this issue because the legality of the warehousing structure was entirely irrelevant for the legality of the Commission’s decision authorising the acquisition by Lagardère.

\textsuperscript{28} Decision of June 27, 2007 (COMP/M.4439—Ryanair/Aer Lingus).

\textsuperscript{29} Ryanair v Commission of the European Communities (T-342/07) Unreported July 6, 2010.

\textsuperscript{30} Weitbrecht “Mergers in an Economic Crisis—EU Merger Control 2008/2009” (2010) E.C.L.R. 276, 284. However, it must be noted that the regression analysis in Ryanair was not the most complicated of economic models.

\textsuperscript{31} Aer Lingus Group Plc v Commission of the European Communities (T-411/07) Unreported July 6, 2010.
mergers that they regard as important. This referral practice ultimately operates on an ad hoc basis without objective standards for the allocation of cases and undermines the one-stop-shop model that was at the heart of the ECMR.

**Demise of market definition?**

The methodology used by the Commission in analysing mergers today, in particular in the consumer products industries, is perhaps inherent in the more economic approach and the SIEC test in that it tries to directly assess to what extent competition is lost as a result of the merger. Such an approach does not necessarily need to work with a market definition; it is attractive because in many markets it may represent a much closer reflection of economic reality than the black and white definition of relevant product and geographic markets. Despite the many challenges that this methodology presents, it is here to stay.

What is less clear is the extent to which this method will be used. It would appear that in many markets, especially for homogenous products, in merger control it will still be highly meaningful and necessary to work with market shares (which, of course, requires the definition of product and geographic markets). In addition, markets will still need to be defined for the assessment of dominance under art.102 TFEU. In addition, and perhaps even more importantly, market shares are the principal dividing line in the Commission’s block exemption regulations and guidelines under art.101 TFEU for the self assessment of the parties. Market definition and market shares as a proxy for market power therefore will continue to play an extremely important role.