



# Merger Review in the United States and the European Union



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# What is Antitrust?

- Fairness Law
  - Protect smaller firms from larger firms
  - Disperse business power
  - Distribute opportunity broadly
- Efficiency Law
  - Preserve the competitive process
  - Advance business efficiency
  - Protect consumers

# What Are the Goals of Antitrust?

- United States
  - Ensure open and free markets
  - Preserve the competitive process
  - Protect consumers
- European Union
  - Integrate the common market
  - Protect firms from abuse of dominance
  - Provide openness and access
  - Level the playing field
  - Foster efficiency and competitiveness
  - Serve consumers

# Key U.S. Antitrust Statutes



- Sherman Act
  - Section 1- prohibits contracts, combinations and conspiracies in restraint of trade
  - Section 2- prohibits monopolization, attempted monopolization, conspiracies to monopolize, and in some Circuits, monopoly leveraging
- Clayton Act
  - Section 7 - prohibits mergers which are likely to substantially lessen competition in a market

# When Does U.S. Antitrust Law Apply to Foreign Transactions?



- 2 Tests:
  - Mergers affecting imports to U.S.: “foreign conduct that was meant to produce and did in fact produce some substantial effect in the United States”
  - Mergers affecting commerce other than imports: foreign conduct that has a direct, substantial, and reasonably foreseeable effect on U.S. commerce

## When is a Transaction Reportable to the U.S. Antitrust Agencies?



- Size of transaction test
  - the acquiring person will hold voting securities or assets in excess of \$50 million
- Size of person test
  - one party has \$100 million in total worldwide assets or annual net sales and the other \$10 million
  - applies only to transactions valued at less than \$200 million

# U.S. Merger Review



Mergers are prohibited if their effect  
**“may be substantially to lessen  
competition or to tend to create a  
monopoly”**

# U.S. Merger Review



- Underlying Principles
  - Collusion is more likely when there are few firms in a market
  - Even without collusion, interdependent pricing and oligopolistic behavior are more likely to occur in a concentrated market

# U.S. Merger Review



- From a Fairness to an Efficiency Approach
  - Brown Shoe
  - Philadelphia National Bank
  - General Dynamics
  - Waste Management
  - Baker Hughes

# U.S. Merger Review



- 1992 Merger Guidelines - mergers that create or enhance market power or facilitate its exercise should be blocked
- What is Market Power?
  - For sellers: the ability to profitably maintain prices above competitive levels for a significant period of time
  - For buyers: the ability to depress prices below competitive levels and reduce output for a significant period of time

# U.S. Merger Review



- Types of Mergers
  - Horizontal
    - Antitrust issues do not arise unless post-merger firm will have greater than 15% market share in either upstream or downstream market and entry barriers are high
  - Vertical
    - Antitrust issues arise when merger eliminates potential competition
  - Conglomerate
    - Antitrust issues arise when merger eliminates potential competition

# U.S. Merger Review



- Assessing Mergers Under the 1992 Guidelines:
  - 1) What is the relevant market?
  - 2) Who are the market participants?
  - 3) What are their market shares?
  - 4) How will the merger affect market concentration?
  - 5) What other factors affect competition in the industry?
  - 6) Are there any available defenses?

# U.S. Merger Review



- What is a Market?
  - “A group of products in a geographic area ... such that a hypothetical profit-maximizing firm ... would impose at least a small but significant and non-transitory increase in price”
- Defining the Market
  - Product Market
  - Geographic Market

# U.S. Merger Review



- Who are the Market Participants?
  - Firms that are selling (or buying) the relevant product(s)
  - Firms that could quickly enter the relevant product market without incurring significant sunk costs

# U.S. Merger Review



- Calculating Market Share
  - Can be based on total sales or capacity dedicated to the market
  - Special rules for foreign firms facing trade restrictions
  - Market shares may be adjusted based on changing market conditions that might overstate or understate significance of share

# U.S. Merger Review



- Calculating Market Concentration
  - HHI is the sum total of the squares of each industry participant's market share before and after the proposed merger.

# U.S. Merger Review



## Pre-Merger

Share      HHI

A.	20%	400
B.	20%	400
C.	20%	400
D.	20%	400
E.	20%	<u>400</u>
		<b>2000</b>

## Post-Merger

Share      HHI

A.	20%	400
B.	20%	400
C./D.	40%	1600
E.	20%	<u>400</u>
		<b>2800</b>
		<b>Increase in HHI: 800</b>

# U.S. Merger Review



- **HHI < 1000**
  - Market is unconcentrated; merger is unlikely to harm competition
- **HHI 1000 - 1800**
  - Market is moderately concentrated
  - If increase to HHI is more than 100, merger raises potentially significant competitive concerns
- **HHI > 1800**
  - Market is highly concentrated
  - If increase to HHI is more than 50, merger raises potentially significant competitive concerns
  - If increase to HHI is more than 100, merger presumptively injures competition

# U.S. Merger Review



- Factors Considered in Assessing Industry Competitiveness:
  - Is the industry susceptible to collusion?
  - Is the industry susceptible to a unilateral exercise of market power?
  - Could new entrants provide effective competition?

# U.S. Merger Review



- Is Collusion or Coordinated Interaction Likely?
  - Firm and product heterogeneity
  - Evidence of past collusion
  - Transparency of market information
  - Industry pricing and marketing practices
  - Characteristics of buyers and sellers

# U.S. Merger Review



- Unilateral Effects
  - Market includes differentiated products
  - Products are undifferentiated: competition over capacity
- Typically considered only when combined market share is greater than 35% and HHI is  $> 1000$

# U.S. Merger Review



- Barriers to Market Entry
  - **Timeliness**: Can entry be achieved in less than two years?
  - **Likelihood**: How attractive is the market to potential new entrants?
    - What is the minimum viable scale for entrants?
    - What sales opportunities exist in the industry?
  - **Sufficiency**: Would entry be sufficient to discipline an exercise in market power?

# U.S. Merger Review



- Failing Firm Defense
  - Target firm in grave danger of business failure
  - Target firm would not be able to re-organize successfully under Chapter 11 of Bankruptcy Act
  - Target firm has made unsuccessful efforts to sell its assets to alternative buyers who pose a lesser risk to competition
  - Without the acquisition, the assets would exit the market

# U.S. Merger Review



- Efficiency Defense
  - 1997 revisions to 1992 Guidelines state that efficiencies which cannot be achieved without the merger and which can be verified will be considered as part of the assessment of competitive effects.

# U.S. Merger Review



- Efficiency Defense
  - Not yet recognized by U.S. Supreme Court
  - Never justifies a merger to monopoly or near-monopoly
  - The greater the harm to competition, the greater the efficiencies needed to justify the combination

# E.U. Merger Review



- Does the Proposed Merger Have a Community Dimension?
  - It does if:
    - Aggregate world-wide turnover is more than ECU \$5,000 million (US \$5,775 M); and
    - Aggregate community-wide turnover of each of at least two of the undertakings is more than ECU \$250M (US \$290M);
    - Unless each of the undertakings concerned achieves more than 2/3 of its aggregate community-wide turnover within one State.
- If thresholds are satisfied, it does not matter whether firms are located in E.U. or whether the transaction might cause effects in E.U.

# E.U. Merger Review



- “A concentration which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it shall be declared incompatible with the common market”  
Merger Control Regulation, Art. II section 3.

# E.U. Merger Review



- What is a Dominant Position?
  - “A position of economic strength enjoyed by an undertaking which enables it to hinder the maintenance of effective competition in the relevant market by allowing it to behave to an appreciable extent independently of its competitors and customers and ultimately of its consumers”

# E.U. Merger Review



- E.C. Assessment of Proposed Mergers:
  - 1) What is the market?
  - 2) Will the merged entity have a dominant position?
  - 3) Will the dominant position create a significant impediment to competition?

# E.U. Merger Review



- Will the Merger Create or Strengthen a Dominant Position?
- Factors Considered:
  - Market position of undertakings / economic and financial power
  - Alternatives available to suppliers and users
  - Access to supplies and markets
  - Legal or other barriers to market entry
  - Supply and demand trends for the relevant goods and services
  - Interests of the intermediate and ultimate consumers
  - Development of technical and economic progress, provided that it is to consumers' advantage and does not form an obstacle to competition
  - Compatibility with the fundamental objectives of the EC Treaty

# E.U. Merger Review



- Decision
  - Transaction may be declared compatible with Common Market without modification
  - Transaction may be declared compatible with Common Market subject to structural or behavioral modification
  - Transaction may be declared incompatible with Common Market

# U.S. / E.U.: Major Differences

- E.U. System Places Greater Focus on Competitors
  - Formally solicits input from competitors in assessing proposed mergers
- U.S. is More Receptive to Efficiency-Based Arguments in Support of Merger
  - Consumer complaints are typically given more credence than those of competitors

# U.S. / E.U.: Major Differences

- E.U. places greater focus on single-firm dominance
- U.S. has traditionally focused on whether merger will facilitate coordinated action / collusion

# Case Study: Boeing / McDonnell Douglas

- Facts

- Merger of #1 (Boeing) and #3 (McD-D) manufacturers of commercial aircraft worldwide
- Boeing's market share was 64%; Airbus was 27%; McD-D was 6%
- Boeing had entered into exclusive 20-year agreements with 3 major airlines
- Huge barriers to entry: entry highly unlikely
- Neither had facilities or assets in Europe
- Relevant market: global

# Case Study: Boeing / McDonnell Douglas

- FTC Analysis
  - McD-D competitive position was in consistent decline
  - McD-D market share overstated its competitive significance
  - Considered exclusive contracts to be ancillary to merger

# Case Study: Boeing / McDonnell Douglas

## E.C. Analysis

- Relevant market: global market for large commercial aircraft
- Boeing's dominant position would be strengthened by merger; market share would increase from 64% to 70%
- Boeing would revitalize McD-D's competitive potential
- Price data indicated that prices were significantly lower when McD-D was a bidder
- Boeing's exclusive contracts with 3 large carriers reinforced its dominance
- Boeing's acquisition of McD-D's defense divisions would give it an unfair competitive advantage
- Airbus' market position was stagnant

## Case Study: Boeing / McDonnell Douglas

- Boeing's Concessions to E.U.
  - Boeing would not enforce its exclusivity contracts
  - McD-D commercial division would be “ring-fenced” from remainder of Boeing for 10 years
  - Licensing of non-exclusive patents derived from publicly funded R&D
  - Annual report to Commission about military and civil R&D funded with public money

# Case Study: GE / Honeywell

- DOJ Required Honeywell to Divest Military Helicopter Engine Business
- EU Blocked the Deal
  - GE has dominant position in market for jet engines for large commercial and regional aircraft
  - GE's vertical integration into aircraft leasing reinforced its dominance
  - GE's ability to “bundle” GECAP financing, Honeywell avionics with its engines would strengthen its dominance