CROCOMPETE

Implementing Croatian Competition & State Aid Policies, 2009-2011

MERGERS CONFERENCE - "Substantive and Procedural Issues in Merger Cases in the context of the Economic and Financial Crisis, with a particular focus on EU Cases"

Zagreb University Economics Faculty

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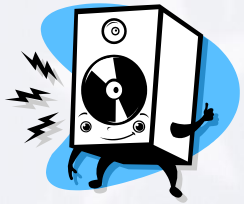
ISSUES CONCERNING MERGERS AND THE FINANCIAL CRISIS

SPEAKER & PROJECT DETAILS



- Mr. André Bywater - a UK-qualified lawyer based in Brussels, specialising in Competition and State Aid
- Experience of working in Croatia for over 7½ years
- Key Legal Expert for CroCompete project assisting the project beneficiary, the Croatian Competition Agency
  - CroCompete: a 2-year EU-funded project raising awareness at different levels in Croatia about Competition and State aid issues
- My approach today is more of an empirical one - the observations and conclusions in this presentation are mine and not those of the Agency !

OVERVIEW

- Presentation Topics:
  - Introduction
  - General Trends
  - Jurisdiction and Nationalisation
  - Failing Firm Defence
  - Remedies
  - State Aid
  - Public Interest Intervention
  - Conclusions
  - Looking To The Future

INTRODUCTION

Directorate General for Competition

- The EU merger rules are now over 20 years old. The key regulation adopted in 2009 was revised in 2004 (Regulation 139/2004, OJ L 24 of 29/1/04). The European Commission 2009 report (COM 2009, 281 of 18/6/09) on the revised rules did not suggest any changes in light of the financial crisis

- The EU merger rules have been significantly used, and, can be claimed to have been a great success, certainly from the Commission's perspective

- My presentation today addresses merger issues in the context of the (on-going) financial crisis that started in the autumn of 2008

GENERAL TRENDS - NUMBERS

- The number of EU merger filings before and during the crisis period:
  - 2006 = 356
  - 2007 = 402 (the highest figure ever)
  - 2008 = 347
  - 2009 = 259
  - 2010 = around 240 so far

- There has been a decrease in the number of filings during the crisis period, considered by most observers as having occurred due to the financial crisis. A key driver of merger and acquisition activity is financial investment and the crisis appears to have affected this. Nevertheless, there has still been merger activity, driven by different reasons.

GENERAL TRENDS - SECTORS

- Key sectors for EU merger filings between 2008 and 2010 are:
  - Banking; Pharmaceuticals; Energy; High Technology; and, Aviation

- The following general observations can be made about this in relation to the crisis:
  - Banking - not many mergers but they have been triggered by the crisis and specific issues have arisen
  - Pharmaceuticals - significant consolidation but not due to the crisis and instead due to sector-specific drivers
  - Energy & High Tech - complex mergers, especially for hi-tech, but which don't seem to be connected to the crisis
  - Aviation - consolidation mergers that are part of a more general trend but the crisis may have accelerated this process

GENERAL TRENDS - ABANDONMENT

- The mining companies “BHP Billiton” and “Rio Tinto” wished to merge and began making merger notifications globally, obtaining regulatory approval in Australia and in the US without remedies being required
- The European Commission opened a “phase-two” investigation in 2008, and, to meet its competition concerns about the deal, required divestiture by “BHP Billiton” of its iron ore and metallurgical coal production
- The merger application was withdrawn, and, among reasons citied as being behind abandoning the deal, “BHP Billiton” referred (in their 25 November 2008 press release) to their:
  - “[…] concerns about the continued deterioration of near term global economic conditions, the lack of certainty as to the time limit it will take for conditions to improve and the risks that these issues imply for shareholder value.”

GENERAL TRENDS - PROCEDURE

- The European Commission's report for its activities in 2009 states the following:
  - "[…] the Commission's merger procedures have proven well suited to their end, also under difficult economic conditions.
  - Notably, the Commission granted six derogations from the 'stand-still obligation' in a number of urgent cases having regard to the prevailing economic climate, albeit in full conformity with a well-established and strict practice."

GENERAL TRENDS - PROCEDURE

- In one case, in the banking sector (COMP/M.5363-Santander/Bradford & Bingley Assets), due to particular urgency, the Commission granted a derogation from the "standstill obligation" within 24 hours
- The Commission has also been prepared to approve mergers ahead of normal deadlines
- In the BNP Paribas/Fortis banking case (COMP/M.5384), despite competition concerns, the merger was cleared subject to conditions within 25 working days, i.e 10 days earlier than the normal 35 working day in "phase one" remedies cases

JURISDICTION & NATIONALISATION

- The Commission's 2009 states the following:

  • "In the wake of the financial crisis, the Commission was confronted with complex jurisdictional issues under the EC Merger Regulation. Indeed, questions arose as to whether nationalisations of financial institutions needed to be notified to the Commission under the Merger Regulation."

  • (The issue is what State-controlled entities should be included in the 'undertaking concerned' for turnover calculation and deciding if the Commission has jurisdiction)

  • "This depended on whether or not the nationalised entity would remain an economic unit with an independent power of decision, or whether such nationalised entity could be considered to form part of a single economic entity with other State controlled undertakings."

JURISDICTION & NATIONALISATION

- The 2009 Commission report continued:
  - "In most cases, the Commission was satisfied that the holding arrangements ensured independence and thus that no concentration was taking place. However, in the German Hypo Real Estate bank case (COMP/M.5508 SOFFIN/Hypo Real Estate) a concentration had to be notified."
  - In this case the Commission concluded that due to: "[…] the far-reaching supervisory powers exercised by "BMF" [the Federal Ministry of Finance], "KfW" [a German bank] cannot be considered an entity constituting an economic unit with an independent power of decision." On the substance the Commission approved the notified merger.

THE FAILING FIRM DEFENCE

- One issue which may arise in a financial crisis is that there may be more companies trying to rely on the so-called 'failing firm defence' (sometimes also called 'rescue' mergers)

- A 'failing firm' is a firm that has been earning negative profits, losing market share and thus going out of business

- A firm acquiring a 'failing firm' (through a merger) may seek to argue that the acquisition of the 'failing firm' will not result in a loss of competition as this firm will be exiting the market anyway, and so there will be no loss of competition on the market overall

THE FAILING FIRM DEFENCE

- The 'failing firm defence' is globally recognised in many jurisdictions
- The EU horizontal mergers guidelines state as follows (OJ C 31 of 5/2/2004):
  - “The Commission may decide that an otherwise problematic merger is nevertheless compatible with the common market if one of the merging parties is a 'failing firm.' The basic requirement is that the deterioration of the competitive structure that follows the merger cannot be said to be caused by the merger.
  - This will arise where the competitive structure of the market would deteriorate to at least the same extent in the absence of the merger.”
- The EU has three key failing firm criteria (forced out of the market, no less anti-competitive alternatives, & the assets would inevitably leave the market)

THE FAILING FIRM DEFENCE

- So, being legally permissible in the EU, where does the 'failing firm defence' stand in the crisis, the issue being whether it might be relied upon more or not

- Commissioner Kroes stated early on in the crisis, in the banking context, that: “[…] the Commission can and will take into account the evolving market conditions and, where applicable, the 'failing firm defence'.” (Speech to the European Parliament, Brussels, 6 October 2008)

- It appears that, as regards banking mergers, the 'failing firm defence' has not in fact really been an issue, nor does it appear to have been an issue in other sectors either so far during the crisis

REMEDIES

- The financial crisis might also affect the conditions under which proposed mergers are authorised
- In order to approve a merger, competition authorities often attach conditions, which aim at eliminating the anti-competitive effects of the merger
- For policy reasons, competition authorities prefer 'structural' conditions ('commitments') over 'behavioural' ones, particularly as the latter require careful later supervision
- The fulfilment of 'structural conditions' usually means the sale of assets to allow more competition, i.e divestiture - but in a time of financial crisis who is willing to buy ?
- This may therefore affect a competition authority's merger approval decision

REMEDIES

- The European Commission's report for its activities in 2009 states the following:
  - "The economic crisis did not have a substantial impact on the Commission's policy and practice regarding 'commitments' in merger cases.
  - 'Structural commitments', and notably divestitures, remained the most appropriate type of remedies in order to prevent, durably, the competition concerns which would have been raised by a merger.
  - In some cases, the Commission, when evaluating a request for the extension of a deadline for the implementation of a remedy, took into account the difficulty of finding buyers in the prevailing economic climate."

REMEDIES

- In the Fortis/ABN Ambro banking case (COMP/M.4844) an extension of the time-frame for divestment was permitted

- Normally, the submission by parties of alternative remedies is not favoured by competition authorities especially as they complicate the procedure (which takes more time in what is already a tight time-frame), but, in the Panasonic/Sanyo batteries case (COMP/M.5421), it was proposed to either divest a business of one party or to divest a business of the other party, and, because each proposal seemed to have their own strengths and weaknesses and neither necessarily offered the better solution the Commission accepted this approach - it is not clear if the context of the financial crisis played any role or whether it was simply the particular circumstances of this case that made it special

STATE AID

- State aid is prohibited but subject to certain specified exceptions and any aid that an EU Member State wishes to provided is subject to the approval of the Commission
- In certain merger cases the collateral (but not central) issue of whether State aid provided has any impact on the proposed merger has been considered (banks: BNP Paribas/Fortis, COMP/M.5384; airlines: Lufthansa/Austrian Airlines, COMP/M. 5440; energy: EdF/British Energy, COMP/M.5224)
- Usually this is not problematic because the aid has previously been authorised by the Commission and so it is not necessary in the mergers context to analyse the impact on competition of the aid, but, an issue has arisen in an on-going case concerning certain German banks where the banks have proposed to merge during an on-going Commission examination of proposed aid to the banks where the issue seems to be: would the merger help the restructuring ?

PUBLIC INTEREST INTERVENTION

- In September 2008, it was announced in the UK that the bank “Lloyds-TSB” had reached an agreement to acquire the bank “HBOS”, and regulatory approval of the deal was sought
- The UK competition authority, “the OFT”, concluded that the proposed merger would be likely to result in “a substantial lessening of competition” in relation to personal current accounts, banking services for SMEs, and, mortgages - normally the next stage would have been a referral to the UK’s “Competition Commission” for detailed examination
- But, the UK Government intervened in the case and approved the merger on “public interest” grounds, under UK competition legislation, on the basis that “the stability of the UK financial system” was now a “public interest” - “public interest” under the relevant legislation had been considered until then as only concerning “national security” and “media public interest”

PUBLIC INTEREST INTERVENTION

- A court case before the UK Competition Appeal Tribunal also failed to stop the merger
- This decision has been criticised by many, notably on the basis that the increased market share of the merged entity will lead to a long-term less-competitive banking market in the UK
- This was also a very bad deal as the “due diligence” failed to reveal UK £10 billion in bad debts of one of the banks !
- The EU merger rules only provide for a “public interest” override system where EU Member States are regulating mergers with an EU dimension (EU referral to Member State)
- Further, Commissioner Kroes stated in the context of the crisis that the Commission had not been prepared in certain cases to allow for “wider considerations such as employment” (Commission “Competition Policy Newsletter”, Number 1 - 2010)

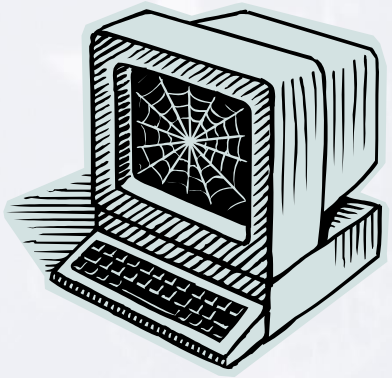
CONCLUSIONS

- There was a drop in merger filings during and due to the crisis but this now appears to have stabilised
- Certain key sectors have seen a lot of merger activity but this mostly appears to be due to consolidation and is not crisis-related, except mainly for the banking sector
- On substantive enforcement there has not been any major relaxation due to the crisis, i.e it is business as usual
- On procedure more flexibility has been shown in response to the crisis context, notably to allow for speedier approval
- Government intervention to facilitate mergers is not necessarily a good thing
- The EU merger rules have stood up well in facing the challenges of difficult financial times

LOOKING TO THE FUTURE

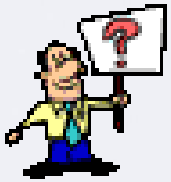
- Will the proposed merger (currently in “phase-two”) between Aegean and Olympic Air be the first Commissioner Almunia prohibited merger ? These two companies cover most of the market in question. A decision is expected in January 2011 …
- Under Commissioner Kroes’ tenure the proposed Ryanair-Aer Lingus merger was prohibited (in 2007 - monopolistic or very significant market dominance would have resulted) and the Commission’s decision was upheld by the [European] General Court (Case T-342/07) - the Greek case is understood to bear similarities to the Irish case
- Watch this space !

RELEVANT WEBSITES



- Croatian Competition Agency:
  http//www.aztn.hr/index.asp
- European Commission Directorate-General for Competition:
  http://ec.europa.eu/competition/index_en.html
- European Court of Justice:
  http://curia.europa.eu
- CroCompete:
  http://www.crocompete.com

Any questions ?



Thank you for your attention !

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