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AGENCY DECISION-MAKING IN MERGER CASES: FROM A PROHIBITION DECISION TO A CONDITIONAL CLEARANCE

-- Note by Sweden --

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More documents related to this discussion can be found at www.oecd.org/daf/competition/agency-decision-making-in-merger-cases.htm

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-- SWEDEN --

1. Introduction

1. In the last five years the Swedish Competition Authority (SCA) has handled a number of merger cases where commitments have been submitted. In addressing the question of agency decision-making, this contribution presents four such mergers, providing a brief background to the case and the remedies in question. In two of the cases, remedies were offered but ultimately not accepted, while in the other two cases, the mergers were cleared subject to remedies.

2. The contribution then explores questions of agency guidelines, design of remedies, the role of market tests and the views of third parties, and the mechanisms for ensuring the effective implementation of remedies, while drawing on the SCA's enforcement experience from these recent cases.

3. The main conclusion from these four merger cases with remedies is that, unsurprisingly, structural remedies are preferred to behavioural as they are easier to assess, implement and monitor.

4. In this context it is relevant to note that if the SCA finds that commitments submitted in a case will eliminate the identified competition concerns, the SCA can conditionally approve the merger. However, in order to prohibit a merger, the SCA must submit a summons of application to the Patent and Market Court. The Court, rather than the SCA, will then rule on the case.

2. Description of some merger cases in the last five years

2.1 *Mergers prohibited where remedies were offered and not accepted*

2.1.1 *Kronfågel/Lagerberg*¹

5. In 2015, the SCA handled a case concerning the Swedish chicken market where the largest chicken producer, Kronfågel, wanted to acquire the third largest producer, Lagerberg. The merger would result in a horizontal overlap and high market shares in particular on fresh chicken and ready roasted chicken sold to consumers in grocery stores. During the SCA's investigation, Kronfågel offered commitments on two occasions in order to remedy the competitive concerns identified by the SCA. The market tests of these commitments, however, gave a negative or fragmented response, and the SCA decided to file a summons application to the Court in order to prohibit the concentration. Shortly afterwards, and before any court proceedings had taken place, the target company found another buyer and abandoned the transaction.

6. The SCA's investigation showed that for frozen chicken, imports to Sweden were substantial and exerted a competitive constraint on the national chicken producers. Further, the target company had a very low production of frozen chicken products. For fresh chicken, however, consumer preferences for Swedish products were very strong. More than 90% of fresh chicken and ready roasted chicken sold to consumers in grocery stores was Swedish, i.e. the day-old chicks were hatched and reared in Sweden. In addition, the trend showed an increasing demand for fresh chicken.

¹ Case reference numbers 472/2015 and 52/2016

7. Other than the merging parties, there was only one other chicken producer of considerable size in Sweden, and hence this was a “three to two” merger. All three of the larger chicken producers faced capacity constraints which would take time to address. First, an expansion in capacity required certain environmental permits both in the producer’s own production plants and among farmers who wanted to increase their breeding capacity. Second, the nature of the business is such that it takes some time to increase the number of parent animals and the number of eggs in the hatcheries, eventually leading to an increase in the number of chickens ready to slaughter for consumption.

8. There was a close interplay and interdependence between the chicken producers and the farmers. No farmer would start breeding at a larger scale without having secured a relation with a producer. The producers on their hand needed to secure a supply of chickens to their production facilities every day. All farmers were tied to a chicken producer within a relatively close geographical distance. The contracts were normally exclusive with a long period of notice. The producers secured deliveries of day-old chicks to the farmers as well as collection of the chickens after 30-35 days for transport to the slaughterhouse for slaughter and processing.

9. Despite capacity constraints, imports of fresh chicken had remained low and prices for fresh chicken were relatively high. The target company, however, was an important and price-pressing supplier of private label products and of ready-roasted chicken to the retail chains. The target also offered fresh chicken products under its own brand at competitive prices to smaller grocery stores. Customers were concerned that after the merger they would face higher prices and increased difficulties in securing supply of fresh and ready roasted chicken to their stores.

10. The SCA concluded that the intended merger would significantly harm effective competition concerning fresh chicken and ready roasted chicken sold to supermarkets in Sweden.

11. The parties submitted two successive sets of remedies with the intention of facilitating other players to enter or expand their activities in the market for chicken production.² The first set consisted of four parts, two of which are worth mentioning in this context. First, the combined entity was to produce and deliver a certain amount of ready-packed fresh and roasted chicken to other producers or resellers. Second, the parties would offer contractual rights to use some of their slaughter house capacity (referred to in the industry as “contract slaughter”).

12. The main part of the offered volumes, and the contract slaughter, would be directed to a new market player already identified by the parties. The rest of the volumes would be offered to any other actor interested in buying them.

13. Hence, the main question in the market test was if these behavioural remedies would be sufficient for the new player to replace the existing competitive constraint that the target company exerted on the two largest chicken producers in Sweden and thus eliminate the identified competition concerns following the merger.

14. The responses from customers and competitors to the first market test were consistently negative. The main reasons were that the volumes offered by the parties were not sufficient to enable a new actor to compete effectively, and that the market specifics indicated that it would take considerably more time than two years to establish a new, national player of considerable size. Doubts were also raised about the idea of contract slaughtering in the chicken business.

² See also the European Commission’s Remedies Notice on access remedies, para. 62-66.

15. The parties therefore submitted a revised set of remedies, which also included a divestment of a small slaughtering facility. In short, the parties argued that the new player now would have the ability to compete effectively, since it would have its own slaughtering facility, together with contract slaughtering and guaranteed volumes of ready-packed chicken for a period of time.

16. However, the second market test and the SCA's analysis showed that even with these combined structural and behavioural remedies there were no certainties of the new player succeeding in replacing the existing competitive constraint. For example, it was questioned whether the new player would find enough chicken farmers to produce chicks, and whether the volumes they would be able to produce would enable them to compete on a national level. Even in the second market test the answers were predominantly negative.

17. Given these uncertainties, the SCA concluded that the remedies offered were not effective in all aspects and would not eliminate the competition concerns entirely. The SCA filed a summons application to the Court in order to prohibit the concentration. Shortly afterwards, and before any court proceedings had taken place, the target company found another buyer and the parties abandoned the transaction.

2.1.2 *Blocket/Hemne*³

18. The SCA's latest case involving proposed remedies concerned the market for digital property listings where the second largest player (Blocket) wanted to buy the largest player (Hemnet). The case was reviewed in 2016.

19. Hemnet is the largest property website in Sweden, with 1.7 million unique visitors per week. Hemnet was founded by two realtor trade associations and two larger realtor firms. The website only lists properties sold through realtors. Blocket.se is the largest overall online marketplace in Sweden and the country's third largest website. Blocket is also active on the digital property listings market, and is the second largest player with 700 000 unique visitors to its property website per week. The website includes property listings both from realtors and the public.

20. In order to remove the overlap between Blocket and Hemnet, Blocket had already agreed with a third party, a small player called Bovision, to provide an exclusive license, whereby visitors to Blocket's website for properties sold through realtors would automatically be transferred to Bovision's website instead. The idea behind the license was that after a stipulated period of time, Bovision would have established itself as a competitor to Hemnet, and the traffic from visitors to Blocket would be cut off. The license would be offered provided the merger between Blocket and Hemnet was cleared by the SCA. Hence, according to Blocket, the acquisition of Hemnet would not result in any horizontal overlap between the merging parties. The acquisition of Hemnet would also, according to Blocket, remove the present loyalty between Hemnet and the real estate agents, in particular the two larger realtor firms that were direct owners and only advertised on Hemnet. This would lower the barriers to entry and expansion for Bovision.

21. However, the SCA's investigation of the merger raised several matters of concern. Firstly, Hemnet already held a dominant position in digital property listings, seemingly constrained only by Blocket. Blocket was a resourceful competitor, part of a media group with wide presence in the online market. The intended licensee Bovision, on the other hand, was a marginal player with limited resources. Other property websites displayed only indexed material from Hemnet and Blocket. There was therefore a clear risk that Hemnet's only competitor would be eliminated as a consequence of the acquisition. Hemnet had already been able to raise its prices and with the elimination of the competitive strain from Blocket, the risk for more price rises increased.

³ Case reference number 84/2016

22. Secondly, there was risk for increased lock-in effects for real estate agents to Hemnet. Blocket's and Hemnet's sellers had agreed that, for a certain period of time after the merger, the sellers would continue to publish non-exclusively a large majority of their objects on the Hemnet website. In addition, real estate agents, when advertising on Hemnet's website, already receive a compensation or kick-back on the invoiced value of the advertisement. This kick-back would remain, and most likely increase, if Hemnet raised its prices on advertisements.

23. Therefore, there was a clear risk that the acquisition would lead to unilateral anticompetitive effects, manifesting primarily as an increase in price on digital property listings but also as a decrease in quality of the products and services provided. The barriers to entry and expansion would increase as well. The SCA thus sent a statement of objections to Blocket and Hemnet.

24. After receiving the statement of objections from the SCA, Blocket offered remedies to alleviate the potential anticompetitive effects identified by the SCA. The remedies included certain limitations of the sellers' commitments to future advertising on Hemnet. Further, the remedies addressed the level and extent of the kick back to the real estate agents when advertising on Hemnet. The remedies also opened up the possibility for the real estate agent to choose to be invoiced for the advertisement instead of the seller of the property. Finally, the remedies included a time-limited price cap for consumers/sellers of property on advertisements.

25. The market test was sent to the ten largest realtor firms in Sweden, representing a large share of the advertisements on Hemnet, and to other suppliers of property websites. The result of the market test was on the whole negative. Already during the investigation, few believed that the license model would enable a player to become a viable alternative to Hemnet. The answers to the market test confirmed that the proposed remedies were not expected to make any substantial difference in the real estate agents' choice of website for their advertisement. The lock-in effects of the sellers' advertisement obligation and the kick-back model would remain. In addition, the time-limited price cap was seen as negative for potential competitors.

26. The SCA found that the proposed remedies could not be expected to prevent the negative effects of the merger or restore competition. When the SCA declared its intent to submit a summons application to court in order to prohibit the proposed acquisition, the parties withdraw the merger notification and abandoned the transaction.

2.2 *Mergers cleared subject to remedies*

2.2.1 *Arla Foods/Milko⁴*

27. In 2011 the SCA cleared the merger between Sweden's largest and third largest dairy companies, Arla Foods and Milko, subject to remedies whereby Arla Foods committed to divest Milko's dairy plant and its most valuable brands. The SCA's decision was the result of a thorough investigation where a large number of stakeholders argued in favour of diverging interests. In particular, Milko's difficult financial situation made this an unusually complicated merger to investigate and assess.

⁴ Case reference number 19/2012

28. The background to the merger was Milko's financial difficulties. If Milko – a farmer cooperative – failed, the situation would quickly become critical for the cooperative members delivering milk to Milko's dairy plants. Their cows would continue to produce milk, but transports to the dairy plants would break down and the milk could be stored only for a few days at the farms. Environmental regulations prevented the farmers from disposing of large volumes of milk at their farms. Therefore, the farmers would urgently need to find another dairy company, or would be forced to slaughter their cows. Arla Foods and Milko claimed that, for geographical reasons, the majority of the farmers in that situation would join Arla Foods. Unlike the merger scenario, however, the transfer to Arla Foods would be more unpredictable and some farmers in geographically remote areas would probably have had to close down. The SCA's own investigation on the whole confirmed this scenario.

29. However, the SCA's investigation also showed that the merger would lead to a considerable limitation of competition in the markets for fresh milk, sour milk, yoghurt and several other products, to the detriment of consumers. The merger would mean that Arla Foods gained control of all of Milko's assets. But in the bankruptcy scenario, some of Milko's assets could have become available to the market and would not necessarily have ended up in Arla Foods' possession. On balance, the possible failing firm scenario could have been better for competition than the proposed merger scenario.

30. Arla Foods committed to divest those assets of Milko which during the SCA's investigation had been identified by other market players as the most interesting ones, namely Milko's main dairy plant and some of its strongest product brands. Consequently, the commitments were adapted so that Arla Foods' already strong position in the dairy sector was not further strengthened by the merger, compared to what would have been the case if Milko had failed.

2.2.2 *Orkla/Cederroth*⁵

31. In 2015 the SCA investigated Orkla's acquisition of Cederroth. Both parties were active as suppliers of consumer products and brands, and both companies had broad product portfolios.

32. The parties' activities overlapped in the segment of health care products and the merger raised competition concerns specifically regarding the supply of weight-loss products to grocery stores.

33. The investigation showed that Orkla, with its brand Nutrilett, was the number one supplier of weight-loss products to grocery chains in Sweden and that Cederroth, with its brand Allévo, was the third largest supplier. Other than the parties, there was only one other supplier of weight loss products to grocery chains. Furthermore, the SCA's investigation showed that there were high barriers to entering, or expanding in the relevant market. For example, sales of the relevant products to grocery stores required substantial investment in marketing and promotion, and therefore placed greater demands on the suppliers. At the same time, this was a product segment with decreasing volumes. The incentives to introduce private label products were very small. A merger between the parties would result in weakened buyer power and higher prices.

34. The SCA's overall conclusion was that the merger would significantly impede effective competition on the market. This conclusion was communicated to the parties. The parties did not raise any discussion about remedies, and the SCA proceeded to file a summons application in court. The SCA's primary claim was that Cederroth's brand Allévo should be divested to a third party before the transaction with Orkla was closed, something the SCA deemed as a proportionate action. The secondary claim was a prohibition against the entire merger.

⁵ Case reference numbers 161/2015 and 514/2015

35. Shortly after the summons application was entered in court, the parties submitted a commitment to divest Allévo in line with the SCA's primary claim. Since the case was now pending in court, the SCA no longer had formal jurisdiction to accept the remedies without the involvement of, and ruling by, the court. Given these special circumstances, no market test was possible. In order to find a solution the SCA had to work closely with the court and the parties. In the end the issue was solved through an adjustment of SCA's primary claim, whereby the SCA no longer required that Allévo should be divested before closing the deal. The parties accepted that the court made a brief judgment of the case and ruled in line with the SCA's adjusted primary claim and the commitments. Accordingly, the parties were obliged by the court to divest the brand Allévo, subject to a conditional fine.

36. Allévo was sold to a third party before the end of 2015 and the case was closed.

3. Guidance

37. The Swedish legislator has deliberately chosen to model the rules for merger control in the Swedish Competition Act (2008:579) on the EU Merger Regulation⁶. The intention is to increase legal certainty and predictability for companies, for example by being able to make reference to the more extensive jurisprudence within the EU. Accordingly the SCA, instead of issuing its own soft law documents, refers to relevant Commission notices and guidelines when applicable. However, the SCA has issued Guidance⁷ in which it provides a brief description of how it deals with merger notifications. In its Guidance, the SCA also explains the connection to EU Merger Regulation and provides a list of the key Commission notices and guidelines to consider. As regards remedies, a reference is made to the European Commission's Remedies Notice.⁸

38. In the Guidance it is stated that if a party provides a voluntary commitment which remedies the identified competition concerns, the SCA may decide to take no further action. This commitment may be imposed subject to a conditional fine.

39. A non-confidential version of the proposed commitments is to be submitted, which can be issued in conjunction with the SCA's market test or form the basis of what the SCA may communicate in external contacts.

40. It is also clearly stated that the SCA may refrain from market testing proposals for commitments which it deems cannot remedy the competition concerns identified in the case. This has also happened in practice. Likewise, the SCA has in some cases refrained from accepting proposed commitments and decided to give an unconditioned clearance to the merger.

41. Any proposed commitments, supplements to these and exact time limits are issues that the SCA and the parties may discuss in the individual case. However, it is important that the parties take into consideration the preconditions for commitments during Phase 1 (25 working days) and Phase 2 (3 months in-depth investigation) respectively.

⁶ Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation)

⁷ Guidance from the Swedish Competition Authority for the notification and examination of concentrations between undertakings, 04/15/2015, Our ref 581/2014

⁸ Commission notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004 (2008/C 267/01)

42. For example, if the parties are considering submitting commitments in Phase 1, they should give notice of this and ensure that the commitments are presented to the SCA as early as possible. Commitments during Phase 1 may only come into question if the competition concerns are clear and easy to remedy. Commitments during Phase 2 should be presented to the SCA no later than three weeks before the time limit for submitting a summons application to the Patent and Market Court expires. If commitments are provided at a later stage during Phase 2, the parties should simultaneously submit a written consent for an application to extend the time limit to enable the SCA to conduct a market test and assess whether the commitments will remedy the competition concerns.

43. In *Arla Foods/Milko*, where the commitments were structural, the SCA was able to market test and evaluate within the ordinary time period of the Phase 2 investigation. In *Orkla/Cederroth* the parties did not present any commitments during the SCA's investigation. The final remedy was however quite clear and straightforward, and could probably have been dealt with within the ordinary time period if presented to the SCA. On the contrary, in *Kronfågel/Lagerberg* and *Blocket/Hemnet* where the commitments were mainly behavioural and more complex, an extension of the time period was necessary.

4. Challenges in the design of remedies

44. As described above, the SCA applies the EUMR and relevant EU Commission notices and guidelines when assessing proposed remedies. Structural or divestiture remedies are, unsurprisingly, preferred to behavioural remedies, since they are easier to implement and do not need any supervision after implementation. Behavioural remedies are normally much more challenging in their design and supervision.

45. In the cases described above, the structural remedies in *Arla Foods/Milko* and *Orkla/Cederroth* worked well. They were fairly easy to implement and have contributed to preserving competitive pressure in the market.

46. It is the view of the SCA that the proposed remedies in *Kronfågel/Lagerberg* and *Blocket/Hemnet* would have been much more complicated to implement and monitor. Further, the market tests, together with the SCA's own investigation and analysis, suggested that the remedies were far from convincing as regards their effectiveness in actually addressing the competition concerns identified in the two cases.

5. Approach to remedies tested in court?

47. The SCA's approach to remedies has never been tested in court. It should be stated that the SCA's decision in a merger case cannot be appealed by a third party.

48. It can be expected that where remedies are proposed but not accepted, the merging parties will refer to their proposed solution in the following court procedures. However, the SCA so far has no experience of this. For example, in *Kronfågel/Lagerberg* and *Blocket/Hemnet*, where the SCA did not accept the proposed remedies, the transactions were abandoned and never tried in court.

6. Opinion of third parties/public in merger decisions and design of remedies

49. Although not bound to carry out market tests, the SCA usually prefers to do so. As already mentioned, the SCA may however decide not to market test proposed commitments that are deemed to be insufficient or inadequate to remedy the competitive concerns in the individual case. On the other hand, a decision to market test should not be regarded as a signal that the SCA has taken the position that the proposed remedies would be effective.

50. The opinion of third parties has an important role in the SCA's merger decisions. The SCA may require data from third parties, send out questionnaires, and hold interviews. It is the SCA's experience that conducting interviews is a valuable tool to reach an understanding of a market, in order to be able to ask immediate follow-up questions and to explore thoroughly the arguments presented by the respondent.

51. Questions asked to third parties during the investigation may help to understand not only how the market works, but also how possible remedies could be designed. For example, in *Kronfågel/Lagerberg*, interviews gave an understanding of the very close interplay and interdependence between farmers and producers in the chicken business, as well as of the customer's purchasing process. This information was also valuable later when the SCA assessed the design of the remedies and the responses to the market test.

52. In *Arla Foods/Milko*, where Milko stood at severe risk of failing, the SCA asked competitors to the merging parties during the course of the investigation whether they or someone else could be interested in Milko or parts of Milko. There was also a third party, representing some of Milko's farmers, that was very interested in taking over Milko's dairy plant. These contacts helped the SCA to identify which assets could be of interest to other players than Arla Foods, such as Milko's dairy plant and its strongest product brands. When designing the remedy, third party contacts also helped the SCA to assess what to include in the divestment of the dairy plant to make it viable. One particular challenge in this case was to identify and remedy the merger-specific effects compared to what would have been the scenario if Milko had failed. A meeting with a trustee with long experience from bankruptcy cases provided valuable insights into how a bankruptcy proceedings work in general and what the likely procedure would be should Milko have failed.

53. There are many challenges connected with market tests. One challenge can be to explain the theories of harm and make the market test comprehensible to the addressee without revealing confidential information.

54. Another challenge is to assess the responses to the market test, such as how to balance responses from various stakeholders with diverging interests. If the proposed remedies include the identity of a proposed up-front buyer, the SCA has held interviews with the company in question in order to understand, for example, the company's financial strength, capability and future plans. In both *Kronfågel/Lagerberg* and *Blocket/Hemnet* interviews with, and information about, the intended new entrants formed an important part of the SCA's assessment of the effectiveness and efficiency of proposed remedies.

7. How to minimize the risk of ineffective implementation of remedies?

55. When it comes minimizing the risk of ineffective implementation of remedies, structural or divestiture remedies are again, unsurprisingly, preferred to behavioural remedies.

56. In *Arla Foods/Milko* as well as in *Orkla/Cederroth*, the remedies were structural divestiture commitments. Given the nature of a divestiture commitment, it was of importance in both these cases that the remedy included mechanisms that ensured that the parties would find a suitable buyer approved by the SCA within a reasonable time.

57. In order to minimize the risk of ineffective implementation the parties had to appoint an independent monitoring trustee who had to be approved by the SCA. The SCA and the monitoring trustee had regular meetings in order to ensure that the parties complied with the commitments. For example, in *Orkla/Cederroth*, focus was placed on the commitment to nurture the Allévo brand with, among others, sales and marketing activities, until it was divested.

58. In *Arla Foods/Milko* on the other hand, the Milko brands were divested very quickly by Arla Foods to various buyers, while the dairy plant remained unsold until the trustee took over the divestment procedure. In this case the monitoring trustee had to give more priority to how the dairy plant and its physical assets were taken care of in the intervening period.

59. Another mechanism in both cases was to include the appointment of a divestiture trustee in the remedies. In practice, the divestiture trustee was the same person as the monitoring trustee.

60. In *Orkla/Cederroth*, in the event of a failure by the parties to enter into a binding agreement for the divestment of the brand *Allévo* within a given time, the divestiture trustee would be mandated to do so instead. The divestiture trustee would be mandated to do so within a specific deadline at no minimum price.⁹ This gave an incentive to the parties to make serious efforts to close a deal before their divestiture period elapsed.

61. In *Arla Foods/Milko*, on the other hand, the dairy plant had been assigned a certain scrap value as the minimum price. The reasoning behind this was that should Milko have failed, a trustee in the bankruptcy would quickly have sold out the various physical assets of the plant in order to raise funds to the creditors. The SCA found it reasonable that a purchaser of the whole dairy plant should pay a price that at least equalled the assigned scrap value of the various physical assets it contained. Before accepting the remedies, the SCA conducted market tests in order to check if the scrap value set by the parties could be considered fair. The assigned scrap value was, however, confidential to interested buyers.

62. The dairy plant was not sold during Arla Foods' own divestiture period. In this case, it can be assumed that the assignment of scrap value lowered the incentives for Arla Foods to conclude a deal. Some potential buyers may also have been reluctant to come forward as long as Arla Foods was in charge of the sales process. When Arla Food's divestiture period ended, the task to sell the dairy plant went to the divestiture trustee instead, in accordance with the conditions agreed in the commitment decisions. The trustee managed to divest the dairy plant to a suitable buyer within the stipulated time period and to a value that exceeded the assigned scrap value.

⁹ See also the European Commission's Remedies Notice, para. 121.