Competition (Jersey) Law 2005 Guidelines

6. Mergers and Acquisitions

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1. INTRODUCTION

Part 4 of the Competition (Jersey) Law 2005 (the Law) deals with mergers and acquisitions (hereafter referred to in the interests of brevity as 'mergers'). Article 20(1) of the Law provides that a person must not execute a merger of a type prescribed in an Order made by the Economic Development Committee (EDC) under Article 20(3) except with, and in accordance with, the approval of the JCRA. Article 22(4) provides that the JCRA may refuse to approve a merger if it is satisfied that the merger would substantially lessen competition in Jersey or any part of Jersey.

The EDC issued the Competition (Mergers and Acquisitions) (Jersey) Order 2005 (the Order) under Article 20(3) on 14 April 2005, and it came into force on 1 May 2005. The Order specifies the mergers that are subject to the requirement for prior approval from the JCRA before they can be executed.

This Guideline is designed to assist parties who may be contemplating entering into a merger (and other interested parties, such as competitors) on:

- how to assess whether the merger is subject to the requirement for prior JCRA approval;
- the JCRA's procedures in assessing a merger, so that parties can take these into account in their planning;
- how the JCRA will assess whether the merger will substantially lessen competition, so that the parties can frame their request for approval with this in mind; and
- when it may be appropriate for the JCRA to grant a conditional approval.

Disclaimer

This Guideline is not a substitute for the Law. Anyone with particular questions concerning the application of this Guideline or the Law to specific facts should seek legal advice. Proof that a person has failed to comply with this Guideline is not proof that a person failed to comply with the Law. The JCRA may, however, rely on non-compliance with the Guideline as evidence toward establishing an infringement of the Law. This Guideline remains subject to amendment or revocation by the JCRA.

2. WHEN WILL A MERGER REQUIRE PRIOR JCRA APPROVAL?

Thresholds

The Order requires a merger to be approved by the JCRA before being executed where the 'share of supply or purchase' of one or more parties to the merger in any product or service exceeds certain thresholds. The merger is subject to the requirement for prior approval in three situations:

- Where it results in a share of supply or purchase of 25% or more being achieved, or increased. This threshold is intended to apply to 'horizontal mergers', i.e. where the parties are existing competitors, and their combined shares of supply or purchase equal or exceed 25%. So for example, where one competitor has 24% and the other has 1%, the parties to the merger would need to apply for approval. Equally, where one party has 15% and the other has 10%, the parties would need to apply.
- Where one party has a share of supply or purchase of 25% or more, and the other has a 'vertical' relationship with that party (for example, as a supplier to or customer of that party). So for example, if a company with a 25% or more share of supply of bricks in Jersey was to merge with a house builder, this would require an application for approval. Equally, if a company with a retail share of 25% of potatoes was to merge with a potato producer, this would also require an application.
- Where one party has a share of supply or purchase of 40% or more, the merger will require prior approval. This is designed to deal with a situation where there is no horizontal or vertical relationship between the parties, but where the merger may nevertheless raise competition concerns. These types of mergers are referred to as conglomerate mergers. An example might be if a major electricity supplier was to merge with a major telecommunications supplier.

It should be emphasised that these thresholds are purely jurisdictional tests, and do not imply in any way that the merger is problematic from a competition point of view. The JCRA can reach such a conclusion only after a full assessment as to whether the merger would substantially lessen competition.

The share of supply/purchase test

The share of supply/purchase test is not to be confused with a market share test. Market shares can be determined only after a proper economic assessment of what the relevant market is (see the JCRA Guideline **Market Definition)**. The 'share of supply/purchase' test is designed to avoid the need for the parties to undertake such an economic assessment – which may be open to varying views – before deciding whether the merger needs approval. To determine whether the share of supply/purchase test is met, the parties should look at the various products and/or services they supply or purchase in Jersey and assess their respective share of the supply or purchase of each product and/or service. A number of measures may be

used in determining share of supply such as value of sales or purchases (i.e., turnover), capacity (in the case of a manufacturing business), floor space (in the case of a retailing business), and/or employees. Where more than one such measure is available, and any of them results in the threshold being exceeded, the parties should apply for approval.

In a number of cases, the selection of the product or service in respect of which share is to be measured may be open to varying interpretations. For example, if two sports goods retailers were to merge, would the parties look at the share of individual products such as sports shoes (or different types of sports shoes) or would they look at the share of sports retailing businesses? As a general guide the parties should look at the various possible alternative descriptions of products or services and if any of them result in the relevant threshold being exceeded, on the basis of whatever information is available, the parties should apply for approval.

In any event, if in doubt, the parties may contact the JCRA for an informal discussion prior to deciding whether to apply. It should be emphasised that because the share of supply/purchase test is not a market share test, the fact that the threshold test is satisfied in no way restricts the parties in their submission as to the relevant economic market in respect of which the competition effects of the merger are to be assessed.

3. WHEN AND HOW TO APPLY FOR APPROVAL

Since the obligation not to execute the transaction without JCRA approval applies to each party to the transaction, it will normally be appropriate for the application to be submitted jointly by both or all parties, although they may appoint a joint representative (e.g. the acquiring business or its legal adviser) for this purpose. The application should be made using the Merger Application Form which is available on the JCRA website.

The JCRA's 'Determination on the time at which and form in which Applications for Merger Approval are to be made' (the Determination) provides that an application for approval should be made (in the case of a private business acquisition) on or after the date when the agreement is signed but before completion, or (in the case of acquisition of a listed company) when the bid is publicly announced.

Before submitting an application for approval of a merger, the parties may ask the JCRA for an informal meeting to discuss (a) whether the requirements for prior approval may apply and (b) any queries the parties may have on the information to be provided in the Merger Application Form. Before agreeing to a meeting, the JCRA will require evidence of a good faith intention to pursue the proposed merger in the form of a signed contract, memorandum of understanding or letter of intent.

A cheque for the JCRA's fee for dealing with the application should be enclosed with the Merger Application Form, - see 'Fees' below.

The merging parties must not implement the merger, or otherwise engage in joint commercial activities, until the merger has been approved by the JCRA. Doing so can result in the JCRA issuing directions against the parties and potential financial penalties of up to 10 per cent of an undertaking's turnover during the period of the breach. The JCRA therefore recommends that all sale and purchase agreements contain a condition precedent making the merger conditional upon receiving JCRA approval, if required.

The Law is concerned with the effect of mergers on competition in Jersey. Accordingly, where a merger involves a multi-national company, the parts of the merger that do not affect Jersey need not be delayed by the JCRA process.

Fees

The Law requires Applicants to fund the JCRA's work in reviewing mergers. The JCRA's fee for its preliminary assessment has initially been set at £5,000. The JCRA has the discretion to reduce this fee in appropriate circumstances. If a full investigation is required, a further fee of £15,000 is payable before the full investigation commences. Delay in paying either fee will delay the JCRA's review of a proposed merger. The JCRA will review these fee levels on a regular basis, and make adjustments if warranted, in the light of experience.

4. JCRA PROCEDURES IN ASSESSING MERGERS

As a first step, the JCRA will check that the Merger Application Form (MAF) is correctly completed. If the MAF does not contain all the required information (see the MAF for further details of the information required), the JCRA will contact the Applicant regarding the missing information and will not register the application until the MAF is complete. The application will also not be registered until payment of the application fee is received.

The JCRA normally would expect to conclude a preliminary assessment as to whether the merger raises competition concerns meriting a fuller investigation within one calendar month of the filing of the MAF. This assumes that full information is provided with the MAF: if it is not, this period may be extended. If such competition concerns are raised, the JCRA would expect to complete its full investigation within an additional four months. The JCRA may extend this period by a further month in particularly complex cases or where additional information is necessary. The JCRA will inform the Applicant as soon as practicable whether any extension will be necessary, but this may not be possible until a detailed investigation is at a relatively advanced stage. On the other hand, the JCRA expects that some mergers can be dealt with more quickly and concluded in less than six months, if not within the first month.

On receipt of the application, the JCRA will publish a notice, in the Jersey Gazette and on its website, stating that the parties have submitted the application and inviting comments on the proposed merger. The JCRA also may approach one or more of the parties' competitors, suppliers and/or customers.

If during the investigation of the application, issues arise that may lead to a refusal of the merger or an approval with conditions, the parties to the merger will be advised of these issues and given the opportunity to respond. Also, if at the end of its investigation the JCRA is considering approving the merger subject to conditions or declining the merger, the parties will be given the opportunity to meet with the JCRA.

The JCRA's final Decision will be placed on the JCRA's website.

The JCRA has the power to refuse approval of a merger if any information it has requested from the Applicant has not been provided within a reasonable time. It should also be noted that it is an offence under the Law to knowingly or recklessly provide material information to the JCRA that is false or misleading.

Confidentiality

The Law requires the JCRA to keep confidential non-public information it receives during a merger investigation; however, this restriction does not apply to information for which the JCRA receives consent for disclosure. When submitting a MAF, the Applicant is instructed to clearly indicate the confidential information it contains. The JCRA thereafter will confirm the scope of confidentiality with the Applicant. The JCRA shall deem the Applicant to have consented to the disclosure of information contained in or submitted with a MAF that has not been so indicated.

5. THE TEST OF 'SUBSTANTIALLY LESSENING COMPETITION'

In this part of the Guideline, the JCRA gives an indication of the factors it will take into account when assessing whether a merger will 'substantially lessen competition'. This is the same test as used in other jurisdictions such as the UK, US, Canada, Ireland and New Zealand. Moreover, it is analogous to the 'significantly impede effective competition' test now applied by the European Commission. In assessing whether a merger substantially lessens competition, the JCRA will aim to apply the test in a similar way to the UK competition authorities, the Office of Fair Trading (OFT) and the Competition Commission, as well as the European Commission. Parties may therefore find it useful also to refer to the OFT and Competition Commission guidelines and the EC guidelines on merger control.[1] It should be noted, however, that the JCRA guidelines are authoritative in Jersey and that the OFT, Competition Commission and European Commission guidelines are supportive only.

A merger or acquisition may be expected to lead to a substantial lessening of competition when it is expected to weaken competition to such an extent that

[1] 'Mergers – Substantive Assessment guidance' May 2003, available at www.oft.gov.uk; 'Merger References: Competition Commission Guidelines' June 2003, available at www.competition-commission.org.uk; 'Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings' O.J. C 31, Feb. 2004, available at http://europa.eu.int/eur-lex/en/.

customers would be harmed. This might be through reduced product choice, output, product quality or innovation, or because prices could be raised profitably.

In assessing whether a merger will substantially lessen competition, it is useful to distinguish between the three types of mergers referred to above, namely horizontal mergers, vertical mergers and conglomerate mergers. An analysis of whether any such merger substantially lessens competition involves:

1. defining the affected relevant market(s);
2. assessing concentration levels in the affected markets;
3. assessing the ability of the merged entity to substantially lessen competition as a result of the merger, either unilaterally or in co-ordination with competitors;
4. assessing whether other market forces, such as the entry of new competitors, eliminate the risk of a substantial lessening of competition; and
5. assessing any pro-competitive effects or efficiencies that may result from the merger.

Throughout this analysis, the JCRA examines both the merger's 'factual' and 'counterfactual.' That is, in reaching a conclusion about whether a merger is likely to lead to substantial lessening of competition, the JCRA makes a 'with and without' comparison rather than a 'before and after' comparison. The comparison is between two hypothetical future situations, one with the merger (the factual) and one without (the counterfactual). The difference in competition between these two scenarios is then able to be attributed to the impact of the merger.

In framing a suitable counterfactual, the JCRA bases its view on a pragmatic and commercial assessment of what is likely to occur in the absence of the proposed acquisition. The status quo cannot necessarily be assumed to continue in the absence of the merger, although that may often be the case. It may be, for example, that a merger is expected to extinguish the prospect for greater competition through the elimination of a vigorous recent entrant, or the merger may involve a business that would not otherwise continue in the market.

The following guidance is provided with respect to horizontal mergers, but is potentially applicable to all types of mergers. Some specific considerations for vertical and conglomerate mergers are provided later in this Guideline.

Define relevant markets

A first step in deciding whether a merger would result in a substantial lessening of competition is to determine the relevant market or markets. The definition of the relevant market is a useful tool for analysing the competitive constraints faced by the merging parties. Relevant markets usually have both a product and geographic dimension. Further details on the JCRA's approach to market definition can be found in the JCRA Guideline **Market Definition**.

Market concentration

Having determined the market or markets that are likely to be affected by a proposed acquisition, the next step is to identify the participants in each market and their respective market shares. In the most common case, where the aggregation is on the supply-side of the market, the primary focus is on identifying suppliers. Where the aggregation is on the demand-side, the primary focus is on identifying buyers in the market.

Existing competitors include those businesses already in the market and those that could enter the market swiftly, by adjusting their product-mix (near competitors). Supply-side substitution by near competitors arises either from redeployment of existing capacity, or from expansion involving minimal investment, in both cases involving a delay of no more than one year.

After identifying the market participants, the JCRA estimates their respective market shares to determine market concentration, both before and after the merger. An examination of concentration in a market can provide a useful indication of the competitive constraints that market participants may place upon each other, providing there is not significant product differentiation. Moreover, the increase in seller concentration caused by a reduction in the number of competitors in a market by a merger is an indicator of the extent to which competition in the market may be lessened.

Market shares can be measured in terms of revenues, volumes of goods sold, and production capacities or inputs (such as labour or capital) used. The JCRA selects a measure based on the availability of data and the nature of the product or services.

As well as absolute levels of market share, the distribution of market shares between the merged entity and other remaining market participants is an important factor in considering the effectiveness of the constraint from competitors on a merged undertaking. The greater the aggregation of market shares, the greater the likelihood that the merger would lead to a substantial lessening of competition. By the same token, an aggregation that would result in a low concentration level is unlikely to result in a substantial lessening of competition in a market.

The JCRA recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market. In order to understand the impact of the acquisition on competition, the JCRA also considers the behaviour of the businesses in the market and the competition that would exist between remaining firms in the market, compared to what would exist in the absence of the merger.

The risk of unilateral or co-ordinated anticompetitive effects

The JCRA assesses horizontal mergers with respect to two potential types of a substantial lessening of competition: unilateral effects (i.e., the ability of the merged

firm to raise prices unilaterally) and co-ordinated effects (i.e., the ability of the merged firm to raise prices with either the implicit or explicit cooperation of other competitors). Each is discussed below.

Because a merger may result in the loss of a competitor, it may be that the competitive pressure on the combined business is reduced and that it gains market power - i.e. the power to increase prices or to reduce output or quality profitably. Such 'unilateral effects' may arise when the merger places the merged entity in a dominant position in a particular market. Unilateral effects also may arise without a dominant position, such as when the products offered by the merged firms are close substitutes in a market characterized by differentiated products. The key question in both cases is whether the merger will enable the merged firms to profitably increase prices with respect to any identifiable class of customers or reduce output or quality. In order to ascertain this, it is necessary to assess the ability of competitors of the merged undertaking to constrain its behaviour.

As well as increasing the scope for unilateral market power, a merger may lead to a change in market circumstances such that either co-ordination between the remaining businesses is made more likely, or the effectiveness of pre-acquisition co-ordination is enhanced.

Co-ordination covers both explicit agreements and tacit forms of behaviour. Tacit co-ordination involves the use of devices such as price signalling, conscious parallel pricing and price leadership. Businesses that would otherwise compete may attempt to co-ordinate their behaviour, in order to exercise market power, by restricting their joint output and raising prices.

The JCRA is of the view that where a merger materially enhances the prospects for any form of co-ordination between businesses in the market, the result is likely to be a substantial lessening of competition.

A merger can lead to other effects in concentrated markets in which there are small numbers of fairly evenly-matched businesses. Although firms may independently seek to maximize profits, they cannot ignore the pricing responses and initiatives of the other businesses. Depending upon the assumptions they make about others' responses, the vigour of the competition between them, and other factors, prices can stabilise at levels above the competitive level. In these types of markets, when seller concentration is already relatively high, a merger is likely to result in a further price increase that might amount to a substantial lessening of competition.

Countervailing market effects

If the merger risks a substantial lessening of competition through unilateral or co-ordinated effects, the JCRA will analyze whether other market forces, such as the threat of new entry or the presence of countervailing buying power, eliminate or substantially diminish the competitive effects arising from the merger.

Entry and potential competition

A merger is unlikely to result in a substantial lessening of competition in a market if the undertakings in that market continue to be subject to real constraints from the threat of market entry. The JCRA therefore will consider whether businesses would be able to enter the market and thereafter expand if prices were to rise and whether there are any barriers that will prevent entry into the market. These barriers exist when incumbent undertakings would have a significant advantage over new entrants, although an advantage created by superior efficiency is not treated as an entry barrier.

There are many ways in which different types of entry barriers can be classified, but it is useful to distinguish between the sources:

- **absolute advantage** – undertakings may not have equal access to important assets or rights. For example there may be regulations that restrict new entry, such as requirements to possess licences or permits. Alternatively, undertakings may have preferential access to important inputs, such as raw materials. For example exclusive access to a port might be an absolute barrier to entry if other ports could not serve the same market;
- **strategic advantages** – these are advantages which an undertaking enjoys from being already active in a market (first-mover advantages). They can arise when new entrants would face sunk costs - those which must be incurred when entering a market but which cannot be recovered on exit. The importance of sunk costs in deterring new entry depends on whether new entrants expect to recover them from the revenue that they will earn operating in the market. If new entrants expect to face vigorous competition from existing undertakings in the market, sunk costs are more likely to deter new entry. The importance of sunk costs will therefore depend at least to some extent on the conduct (or expected conduct) of the market incumbent; if the incumbent itself has incurred sunk costs that may make it more likely to respond vigorously to new entry. A strategic advantage might also arise if new entrants find it more difficult to fund the necessary investments than incumbents; and
- **exclusionary behaviour** – for example an undertaking may build up a reputation for predatory behaviour, which will deter new entrants. Undertakings can also conclude contracts which tie up distribution: a manufacturer might tie up all retailers within a market exclusively to its products, for example. Such behaviour can increase the impact of an absolute or strategic advantage.

It is also important to take into account the rate of innovation within the market. In markets where high rates of innovation occur, or are expected, barriers to entry may quickly be eroded.

For market entry to be a sufficient constraint on the merged undertaking, it must be likely in commercial terms and at a scale that is likely to cause the merged undertaking to react in a significant manner. For instance, entry into a market niche may not be a credible constraint. Entry must also be feasible within a sufficiently short timeframe to prevent the exercise of market power. The appropriate time period will depend on the characteristics and dynamics of the market.

Other constraints

Consideration may also be given to other factors which would constrain the merged undertaking from exercising market power. For example, the potential for the merged undertaking to exercise market power may be sufficiently constrained by a buyer or supplier to eliminate concerns that an acquisition may lead to a substantial lessening of competition. This would include the ability of a purchaser within a reasonable timeframe to switch to credible alternatives if the supplier decided to increase prices or to deteriorate the conditions of delivery.

A purchaser would be able to credibly exert such countervailing power if it were large in relation to suppliers, well informed about alternative sources of supply, readily able to switch from one supplier to another, and able to foster new supply (including own-supply). In such circumstances, the JCRA considers whether that situation would be sufficient to constrain market participants to such an extent that competition would not be substantially lessened.

Undertakings may also be constrained by government regulations. In this situation the undertaking may still be considered to be dominant although regulation may prevent it abusing that dominant position.

Efficiencies

Another factor that may need consideration is whether any efficiency gains result from a merger. The focus is on whether the efficiencies will enhance rivalry between remaining businesses in the market. For example, where two smaller businesses merge and, through the efficiencies they achieve, the combined business can exert stronger competitive pressure on larger suppliers, the merger will increase rather than reduce competition.

If claimed efficiencies are to be taken into account, the JCRA will need to be satisfied that the efficiencies:

- will result in a short period of time;
- will result as a direct consequence of the merger;
- will increase rivalry amongst the remaining firms in the market; and
- are not otherwise achievable without the merger.

6. VERTICAL MERGERS

Where a company acquires one of its suppliers or customers, this may give rise to competition problems, even though its market share is not increased. For example, the acquisition by a supplier of a customer may reduce outlets for competing suppliers to such an extent as to weaken the competitive threat exerted by those suppliers. Equally, the acquisition by a retailer of a wholesaler or manufacturer may weaken

substantially the competitive pressure exerted by competing retailers by denying them access to a source of supplies or allowing them access only on unfavourable terms.

Generally, however, a vertical merger will only raise competition concerns when one or both the firms involved are able to exercise a substantial level of market power in one or more of the markets concerned. Following an analysis analogous to that outlined above, the JCRA will assess whether the vertical merger would strengthen the firm's position in any of the markets concerned, and whether this would lead to a substantial lessening of competition.

7. CONGLOMERATE MERGERS

Generally, mergers between firms operating in different markets do not substantially lessen competition. However, there may be cases where competition problems arise. For example, where there are common customers, the ability of the merged entity to offer customers bundles of products or services at a discounted price may place suppliers of only one of the products or services at competitive disadvantage.

8. JCRA DECISIONS

As discussed above, in arriving at a decision whether to approve a merger, the JCRA considers the probable nature and extent of competition that would exist in the relevant market(s) in the absence of the proposed merger. The JCRA also considers the nature and extent of the contemplated lessening of competition that would arise in the same market(s) were the proposed merger to proceed.

On the basis of the above analysis, the JCRA assesses, on the balance of probabilities, whether it can be satisfied that the proposed merger would substantially lessen competition in the relevant market or markets. If it is so satisfied, it will not grant approval for the merger, or will grant approval subject to conditions (see below for more detail on conditional approvals). If it is not satisfied that it will result in a substantial lessening of competition, it will grant approval for the merger.

Imposing conditions on mergers

Under Article 22(1) the JCRA may attach conditions to its approval of a merger. The attachment of conditions would be appropriate where the JCRA is satisfied that, without conditions, the merger would substantially lessen competition, but, if one or more conditions were fulfilled, the merger would not do so.

Examples of situations where the attachment of conditions may be appropriate include the following:

- Where a horizontal merger involving two retail competitors would substantially lessen competition in only one part of Jersey, or in a limited number of products. In the first case, a condition that the merger can proceed as long as retail outlets in

a particular geographical areas are excluded, or subsequently sold off, may allow the merger to proceed. In the second, again the exclusion or subsequent sale to a third party of a particular product range may allow the merger to proceed. Parties are encouraged to raise with the JCRA at the earliest opportunity any conditions that may allow the merger to proceed.

- In a vertical merger that involves one company acquiring a critical source of supply for it and its competitors, a condition assuring continued supplies to competitors on reasonable commercial terms may be appropriate.
- In a conglomerate merger, where it may be appropriate in certain circumstances to require as a condition of the approval that the merged enterprise does not grant discounts for bundled products or services at such a level that suppliers of individual components of the bundle cannot complete profitably.