"Potential Competition" Concerns in Mergers – Can We Hang Our Hats On This?

The theory of "potential competition" has increasingly appeared in merger decisions by the South African Competition Authorities recently, wherein it has been questioned whether one of the merging parties would, absent the merger, become a competitor to the other merging party, even if this is not the case at the time of the merger.

This note looks at the types of mergers where this concern may be raised. It also looks at some recent examples and reviews these. And finally, it considers the (relatively high) bar required for this to gain traction as a concern in a merger assessment.

Which type of mergers is this applicable to?

Potential competition concerns may arise in conglomerate mergers, i.e. where the merging firms have no vertical relationship, nor do they exhibit any horizontal overlap, but are rather active in markets of weak or residual substitution, or in complementary markets. This may arise in discussions of "portfolio effects" or "neighbouring markets". Complements may be of technical nature (one product cannot function without the other), economic nature (products that are consumed together, like coffee and milk), or commercial nature (when they form part of a range which downstream agents, such as multiple retailers, need to carry).

In such cases no actual competitor is removed by the merger. There may nevertheless be a concern that one of the merging firms may enter into the market of the other, absent the merger, especially since they are operational in a relatively close market and so may have some of the skills and know-how to enter.

Such concerns about potential competition may arise alongside concerns about entrenchment through economies of scale or scope or branding/ marketing of a range of products (less likely to date to gain much traction as being anti-competitive) and tying and bundling or related rebates (there is plenty of literature on this as a potential concern and therefore this note does not delve into that).

Potential competition concerns may also arise simply in mergers where there is no horizontal or conglomerate relationships between the merging parties, but where there is concern that one of the merging firms may enter into the market of the other, absent the merger. This may even arise in vertical mergers.

Proof of significant intentions to enter are required for concerns around potential competition to gain traction.

Regardless of the scenario where this is raised, the bar for potential competition to be a concern appears high. This is illustrated by some of the cases mentioned below.

What are recent merger examples of these concerns?

In the 2016 Dow DuPont merger there was concern regarding maize seeds. Here the Tribunal's documents discussed,

"The merging parties... submitted that the proposed merger does not result in the removal of potential competition since Dow would not have entered the South African market given 'failed' hybrid tests. The Commission disputed this. The Commission stated that it found evidence suggesting that Dow's maize seed initiatives in South Africa included actively considering entering into South Africa through a joint venture with a local seed company, Klein Karoo. The plan was that Dow would have an ownership stake of 51% in the joint venture to enable it to commercialise traits in South Africa, with the objective of moving toward full ownership. The Commission further found that Dow and Klein Karoo have had a lengthy commercial relationship dating back to 2001 and that Dow has been supplying a number of maize hybrid seeds to Klein Karoo for field trials and testing."[1] This case goes on to support that proof of significant intentions to enter are required for concerns around potential competition to gain traction – in this case the bar was met, and licensing of the relevant maize products with non-exclusive access by third parties remedied this concern.

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Concerns about potential competition were also raised in the highly contested but ultimately approved 2016 AB InBev/SAB merger[2]. Here the Tribunal's documents discussed whether AB InBev would have been a potential competitor to SABMiller in beer sales absent the merger since a document was found that alluded to this: *"In order to decide on whether the merger would likely lead to an anticompetitive effect we have to choose between these two sources of evidence. One source of evidence is the divested and acquired market shares. The other, conflicting source is based on a strategic plan's medium-term projection of what market share might be gained. While the potential competition scenario might posit a more competitive market it is premised on untested assumptions, about which we can be highly skeptical. By contrast, the evidence of the net market shares post-merger, are based on much more solid foundations being the actual market shares as they are at present. Thus, the potential competition scenario posed by this counter-factual is insufficiently probative."* Ultimately here it was highlighted by the Tribunal that even if there would have been entry, that this would have been at the premium end of the market and ''would not have dented the core'' of SABMiller's sales. The latter seems to recognize the importance of a competitive effects assessment.

Other non-merger cases also provide insights. The 2014 CC vs SAB and Others case before the Competition Appeals Court[3] e.g. discussed: *"In order to determine the competitive relationship between the parties it is necessary to examine whether the parties would have been actual or potential competitors in the absence of the agreement. If without the agreement the parties would not have been actual or potential competitors in any relevant market affected by the agreement, they are deemed to be non-competitors. The EU approach thus provides that, if an undertaking would have not competed, absent the impugned agreement, then the agreement itself cannot be said to have been entered into between horizontal competitors but rather stands to be classified as an agreement between an upstream manufacturer who is engaged in a new distribution strategy with its downstream suppliers."* This follows on from the European approach.

Whilst this note does not endeavor to provide a full list of cases where potential competition has been raised, we note that potential competition is also raised in some recent 2018 and 2019 mergers before the Competition Authorities. Per illustration:

In the Competition Commission's 2018 prohibition notice of the Airlink/ Safair merger it was discussed that, *"The Commission is of the view that the merger is likely to result in the removal of an effective competitor to SA Airlink on the routes it currently operates on. Safair offers competitive prices and has been growing in the market both in terms of its existing routes, as well as recently entering new routes. Safair is also a potential competitor of SA Airlink in those routes which it has not yet entered and is likely to pose a competitive constraint on SA Airlink bearing in mind its currently competitive pricing on competing and non-competing routes."*[4]

In the Competition Commission's 2019 prohibition of the WeBuyCars and MIH eCommerce (subsidiary of Naspers) merger it was discussed that, *"Although the Commission found that the proposed transaction does not present any*

1 LM030May16.

2 LM211Jan16.

3 129/CAC/Apr14, par. 41-42.

4 Competition Commission, Media Statement, 23 February 2018 and 7 November 2018 (the latter indicates that this merger was abandoned by the merging parties).

competitor (horizontal) overlap in South Africa as the Naspers Group is not active in the buying and selling of cars, it was found that the Naspers Group through Frontier Car Group Inc (FCG) has been anticipating entering the South African market for the wholesale and online buying of used cars in competition with WeBuyCars. These entry plans were thwarted directly as a result of the merger. Given this potential entry, the Commission assessed if the proposed merger will result in the removal of potential competition in South Africa as Naspers Group had plans to enter the South Africa niche wholesale buying of used car market segment utilising the instant cash model and compete directly against WeBuyCars. With respect to the removal of potential competition concern, the Commission is of the view that the proposed transaction will result in the removal of Naspers Group (FCG) as a potential effective competitor to WeBuyCars in the niche segment of wholesale and online buying of used cars using an instant cash model from the public and the consequent selling to dealers and others. This is the market segment that is currently dominated by WeBuyCars, which owns a significant share of this market."[5] The Tribunal date is set for 6 November 2019.

Albeit that the merging parties could have entered into each other's markets, they did not, since they did not have the capabilities. Where consideration of this was documented, it was found that an entry by one into the other's market was for production of a limited and backup supply in the case of other supply disruptions – i.e. this was never to replace the other in any way...

In the 2018 Timrite/Tufbag merger (Decision February 2018, Reasons May 2019)[6] also provides some insights. This merger was prohibited by the Commission on the basis of potential competition but approved by the Tribunal, with conditions. More specifically, it was alleged that the merging parties in this vertical merger would have been competitors in each other's markets absent a particular agreement between them for the manufacture and supply of a specific set of products covered by Intellectual Property. It was therefore alleged that the merger would entrench this supposed market allocation. The Tribunal however overturned this by finding that albeit that the merging parties could have entered into each other's markets, they did not, since they did not have the capabilities. Where consideration of this was documented, it was found that an entry by one into the other's market was for production of a limited and backup supply in the case of other supply disruptions – i.e. this was never to replace the other in any way.

What is the bar for this to be a concern in mergers?

The above cases provide insight into the bar generally required for potential competition to be a concern in mergers. Whilst there does not appear to be a clear line in the sand for this bar (and many of the above notices do not convey information about the nature of the exact documents that were relied on in testing the likelihood of potential competition), it does appear that significant proof of intentions to enter into a competitor's market, absent a merger with that competitor, is required.

European competition policy provides insights into the definition of horizontal competitors: *"Two companies are treated as actual competitors if they are active on the same relevant market. A company is treated as a potential competitor of another company if, absent the agreement, in case of a small but permanent increase in relative prices it is likely that this first company, within a short period of time normally not longer than one year, would undertake the necessary additional investments or other necessary switching costs to enter the relevant market on which the other company is active. This assessment has to be based on realistic grounds; the mere theoretical possibility of entering a market is not sufficient."*[7] From this, it seems to be the case that even if two companies are potential competitors, their entry into a market must be based on sound evidence and not merely on theory.

The US Horizontal Merger Guidelines (2010) are slightly vaguer. Here it is stated that in evaluating evidence of direct competition, the Agencies *"consider whether the merging firms have been, or likely will become, absent the merger, substantial head-to-head competitors."* (Section 2). This document provides some discussion of potential maverick firms that may disrupt the market to the benefit of consumers; and committed and rapid entrants, i.e. those firms that may not currently be earning revenues in the relevant market but that have committed to enter in the near future, or those that would very likely provide rapid supply responses with direct competitive impact in the event of a SSNIP[8], without incurring significant sunk costs.

Potentially in line with the last point the US literature indicates little traction in this area. Royall and Vincenzo (2010)[9] e.g. discuss: *"There has not been a federal court of appeals merger decision applying the potential competition framework since the 1980s...The new Guidelines elevate the importance of direct evidence of competitive effects."*

In South Africa there is no explicit guidance on this, but as discussed above, some of the recent cases provide insights.

Salop and Culley (2014) also discuss potential entrants and necessary steps to determine competitive effects. In this they state that ahead of a vertical merger, either or both of the merging firms could be potential entrants into the other

5 Competition Commission, Media Statement, 15 May 2019.

6 IM100July17.

7 See European Commission Notice on the definition of the relevant market for the purposes of Community competition law, OJ C 372, 9.12.1997, p. 5, at paragraphs 20 to 24, the Commission's Thirteenth Report on Competition Policy, point 55, and Commission Decision 90/410/EEC in Case No IV/32.009 — Elopak/Metal Box-Odin, OJ L 209, 8.8.1990, p. 15. Referenced in the European Commission's Guidelines of Vertical Restraints, p.12.

8 Small but significant and non-transitory increase in price.

9 Royall and Vincenzo, 2010, pp.35-36.

firm's market: *"Established firms competing in adjacent markets may be well-situated to enter because they may have expertise relevant to that market or easier access. The fear of entry by a customer or supplier may serve as a constraint on the pre-merger prices of a firm. The merger would reduce or eliminate this constraint. If either of the merging firms is the most likely perceived or actual potential entrant (or among a few most likely potential entrants) into the other's market, then the merged firm may be able to raise (or maintain supra-competitive) prices in the affected market."*[10] Following this they outline that the following would be particularly relevant to evaluating these potential competition concerns:

- Analysis of the pre-merger market structure in the upstream and downstream market, with a focus on whether either of the merging firms currently have significant market power and whether entry would make a material difference to competition.
- Evaluation of whether one or both merging firms are potential competitors (either actual or perceived potential entrants) into the market of the other, including any concrete plans for entry.
- Evaluation of whether there are enough other entrants equally well-positioned to replace the loss of any potential competition provided by the merging firms. [11]

10 Salop, S. & Culley, D. P., 2014. Potential Competitive Effects of Vertical Mergers: A How-To Guide for Practitioners, p. 11.

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Taken together, international guidelines and literature, as well as the local precedent appears to provide guidance and insight into the bar that is required for potential competition to be a concern. Whilst this is an area where developments are expected, it seems prudent to carefully consider the facts of the case and provide strong evidence of both potential entry and – related to this – the significance of the competitive effect of any potential entry.

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