ANTITRUST RISK RE-ASSESSMENT IN NEWLY CONCENTRATED MARKETS: PRACTICAL WAYS TO PRESERVE FREEDOM FROM INVESTIGATION

By Samantha Mobley & Grant Murray[1]

I. INTRODUCTION

Securing merger control clearance is a prime antitrust concern for parties undertaking "mega mergers." Significant resources will be focused on understanding and addressing regulatory concerns and the process may become protracted and public, especially where risk-shifting provisions—such as hell or high-water clauses or reverse break-up fees—lead the buyer to do everything in its power to get clearance on the right terms.

But the antitrust issues may not end with merger control clearance. Transactions leading to, or enhancing, a high degree of market concentration can mean that companies or a sector remain in the antitrust spotlight.

Indeed, a recent report by the Council of Economic Advisers[2] (which advises the U.S. President on economic policy) expressed concerns that competition is being eroded in many industries across the United States including as a result of increased consolidation. The Council favored increased governmental involvement, including antitrust enforcement by the DOJ and FTC.

Not long after, President Obama issued an executive order[3] requiring all executive agencies and departments to take steps to address competition concerns. By May 15, executive agencies are to submit a report to the Director of the National Economic Council which includes a list of actions each can "potentially take." The report will also include any specific anticompetitive practices the executive agency has observed and the authorities it has available to take further action.

Risk-assessments are a well-known and well-trusted tool in the sphere of competition law compliance.[4]

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[2] https://www.whitehouse.gov/sites/default/files/page/files/20160414_cea_competition_issue_brief.pdf.

[3] https://www.whitehouse.gov/the-press-office/2016/04/15/executive-order-steps-increase-competition-and-better-inform-consumers.

[4] http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2013/ICC-Antitrust-Compliance-Toolkit/.

This article explores what sorts of compliance precautions a company can consider when it finds itself in a highly concentrated market and may therefore be more vulnerable to complaints and investigation.

It provides practical suggestions on how to deal with information exchange and trade associations (where an enlarged company may expect (and be expected) to play a bigger role; joint ventures and consortia/sub-contracting with competitors; price signaling; collective dominance; and market investigations.

While there is no need for companies in concentrated markets to be over-cautious about antitrust, a few additional legal checks and balances may preserve a company's commercial freedom and freedom from investigation.

II. A TENDENCY TOWARDS OLIGOPOLY

Most markets tend towards oligopoly over the longer term. Markets may consolidate when winners rise to the top (thanks to efficiencies and innovation) and losers are forced to exit. Consolidation may also result from M&A activity which can be intensive, with sectors sometimes experiencing a boom of high profile acquisitions.

This does not necessarily imply that competition is impaired. A concentrated "sector" is not necessarily the same as a concentrated "market." Even in highly concentrated markets, there may be effective competition. A low number of firms on the market might disguise the fact that intense competition is actually playing out between those firms. This is sometimes the case in the pharma sector where the total number of firms active in a particular product market may be small and constant—but where the identity of those firms changes over time, as one firm "wins" the market, only to be supplanted in the future by a rival with a superior product.

Highly concentrated markets can of course give rise to competition issues. Consolidation could mean that a firm obtains market power—whether on its own or, in some jurisdictions, collectively. Tight oligopolies can display characteristics which are more conducive to cartel conduct or at the least tacit coordination where firms are able to predict their rivals' future behavior and align to that expectation, without colluding. Similarly, in a more concentrated market, practices which might have been borderline or even benign in competition terms may begin to attract the attention of competition authorities.

The oligopoly issue is not new. Textbooks are replete with cases and observations on how competition agencies have tried to tackle it, often with a degree of creativity. European reforms in 2004 sought to ensure jurisdiction over "non-coordinated" effects, including where a merger might impair competition without leading to the emergence of a firm with a paramount market position. Many countries use legal presumptions to flip the burden of proof when companies adopt parallel behavior (so that companies and not the agency have to show innocence). The notion of "collective dominance" is familiar to many jurisdictions (even if the notion of "abuse" of collective dominance is less clear).

An emerging concern is that the European Commission is becoming more aggressive when assessing mergers that result in high levels of concentration. In some sectors (*e.g.* pharma), the Commission has started to look at the impact of a merger on R&D efforts despite the fact they are at a very early "pipeline" stage. The Commission has also expanded the category of "non-coordinated" effects to enable it to intervene in relation to mergers of companies that are not each other's closest competitors, but merely close competitors—and even to mergers between parties that are not close competitors, but where one of the parties is an "important competitive force."

In some quarters, allegations have been made that traditional antitrust rules are not "fit for purpose" and that the agencies should do more, lest they let consumers down.[5] These assertions are unlikely to have prompted agency action—though they have certainly been heard and relayed by high ranking competition officials.

[5] https://www.washingtonpost.com/posteverything/wp/2015/10/28/the-next-president-should-break-up-some-big-companies/ http://www.wsj.com/articles/wave-of-megadeals-tests-antitrust-limits-in-u-s-1445213306.

In any event, seemingly innocuous conduct in oligopolistic markets remains a focal point for competition agencies. The European Commission is currently investigating price signaling between competitors[6] and has treated information exchange between competitors as serious cartel conduct—even though the information may be about pricing factors (as opposed to price) and the people involved were not responsible for pricing within their companies.[7]

The U.S. DOJ's Antitrust Division is currently looking into allegations of collusion between airlines.[8] Although the allegations are undefined, they are thought to relate to public statements by airline executives. This probe comes on the heels of fast-paced consolidation in the sector. Since 2008, four mergers have reduced eight big airlines to four.

III. HIGHER CONCENTRATION IS CONDUCIVE TO COLLUSION

Enhanced agency scrutiny of compliance with existing rules is practically guaranteed. An in-house lawyer may find themselves stuck in the middle of the oligopoly problem: the inability of agencies to differentiate between unilateral conduct (independent actions/reactions) and coordinated behavior which offends the rules. Some regions, *e.g.* Eastern Europe seem more suspicious than others of parallel conduct. In certain sectors that risk may be greater.

Higher concentration means that contacts with competitors (*e.g.* information exchange) are more likely to have an impact on the market. Practices that were not thought to be risky or were borderline may now be prioritized by the agencies. Companies in newly concentrated markets cannot avoid every risk. There is no need to be overcautious—but they should pay additional, scrupulous attention to avoid creating risk.

One area for extra vigilance and perhaps additional housekeeping rules is trade association activity—not least where an enlarged company may expect (and be expected) to play a bigger role. A company's legal department could require notification before the company becomes a member of a new association. Approvals could be required before individuals join or attend formal/informal subgroups where the case law suggests that people might sometimes become desensitized to the risks. Social activities connected with trade associations have also been shown to be fertile ground for collusion. If this is a risk, an enhanced compliance program could require a brief report on every social contact (with details of who was there, when and why).

Contacts with ex-colleagues are a common source of problems. If this is a risk, then the company could impose a short "quarantine period" during which contact with any ex-colleague would requires pre-approval—and perhaps also special training, *e.g.* if they were spouses/golf partners, etc. This may be a particular risk where a transaction has required divestments as a condition of merger control clearance. In those circumstances, employees might find themselves in the same room with a former colleague who now works for an important competitor.

Joint ventures with competitors are another area to consider. In highly concentrated markets, it makes sense to conduct a review of all joint ventures with competitors. That would consider where they are located; what they do; how they actually operate in practice. If the event of a complaint, competition authorities will look closely at whether the parent companies have taken steps to manage the flow of any competitively sensitive information. Rules/guidance on this topic should be in place for nominated directors and any secondees.

In markets characterized by bids/tenders, it will be important to involve the company's legal department in the discussion (and vetting) of possible sub-contracting arrangements and consortia bidding scenarios whenever competitors are involved. It may also make sense to think laterally about any other "joint" industry activity. Government lobbying for example may be common in an industry but treated differently

[6] http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=1_39850.

[7] Judgment of the Court (Second Chamber) on March 19, 2015, *Dole Food Company Inc. and Dole Fresh Fruit Europe v. European Commission* ECLI:EU:C:2015:184.

[8] http://www.wsj.com/article_email/justice-department-probes-airlines-for-collusion-1435775547-lMyQjAxMTA2MTAzMzAwMjMxWj.

according to applicable competition laws.

Indirect contacts with competitors should also be considered. A number of competition authorities are looking at price signaling. To head this off, companies may wish to enhance pre-approval processes for management speeches, analyst briefings and any other public presentation which could touch on commercial matters, especially pricing.

Steps should be taken to avoid giving an incorrect impression to the market and authorities that collusion underpins business decisions which were in fact taken unilaterally. The not insurmountable challenge is to develop a process which enables a company's legal department to trace how pricing decisions are made both generally and on specific bids so that the independence of the process can be demonstrated if challenged. This could initially focus on the countries which tend to be most skeptical about parallel conduct.

IV. NEW CONCENTRATION = NEW RULES

Additional competition rules may start to apply to a company (and its competitors) because of an altered market structure. For example, a number of countries have presumptions/deeming-provisions relating to collective dominance (which might be met because of a merger between third parties). In addition, some countries may have a low presumption for single-firm dominance.[9] There seems to be no international consensus on how a position of collective dominance can be abused (individually or collectively) but what is clear is that conduct which can be taken to target new entrants is very risky.

Companies with material positions in countries with deeming-provisions should consider whether their sector is likely to be an enforcement priority, including because of a realistic prospect of customer complaints. Companies should consider the impact of these laws on their compliance program: pricing, refusal to deal, exclusivity, discrimination, etc.

Companies also need to be alert to the bigger picture. Many countries around the world have "market study" powers, allowing their competition authorities to investigate a sector thoroughly—despite there being no allegation of any individual wrongdoing. These investigations always prove to be time consuming and expensive for companies. They can also lead to outcomes (*e.g.* divestment) which may not be possible under generally applied competition enforcement powers. Companies need to be on guard for suggestions by the competition agency/government or by third parties (customers, suppliers) that the sector is displaying "market failure" symptoms, *e.g.* public restrictions of competition; customer inertia; information asymmetry between customers and suppliers, etc.

V. FREEDOM FROM INVESTIGATION

High(er) concentration gives rise to a greater vulnerability to complaints and investigation. This is not a reason to be over-cautious. But additional legal checks and balances may preserve a company's commercial freedom and freedom from investigation.

Arranging a brainstorm with the company's antitrust team on where enhanced risks may lie and what mitigation steps can be put in place is a sensible move. Some of the outcomes may be simple and yet avoid unnecessary pain in the future. For example, companies need to get the terminology straight: how should internal documentation (a major part of every investigation these days) describe the company's market position in a way that is accurate but will not need justification in another context? Deeper thinking will need to take place about how compliance efforts should change to address some of the areas outlined above.

Internal procedures are also crucial. Companies in newly concentrated markets should enhance internal processes so that any escalated complaints are reviewed by the company's legal department early. Some complaints should raise serious red flags, *e.g.* failure to bid or discrimination to prevent market entry.

[9] Germany, China, Russia, Indonesia, Taiwan and Vietnam have deeming-provisions for collective dominance. Brazil is an example of a major jurisdiction with a relatively low market share presumption of singe firm dominance (20 percent).

The company's legal department may also want to consider whether to carry out a post-merger "health check." It is notoriously difficult to spot the most serious antitrust violations as part of due diligence but an intensive audit after a deal has closed can help identify areas for follow up (whether with the seller or a competition authority).

Looking ahead, another consideration for a company in a highly concentrated market is that there may be more consolidation to come. From a merger control perspective, there may be an advantage in being the first to move—before the agencies decide that enough concentration is enough.