COMPETITION AND FAIR TRADING COMMISSION

Just Competition, Fair Trading

MERGER ASSESSMENT

GUIDELINES

COMPETITION AND FAIR TRADING COMMISSION
OFF MANDALA ROAD
MPIKISANO HOUSE
P/BAG 332
LILONGWE 3
TEL: +265 1 759 506/7
FAX: +265 1 759 522
E-mail: competitioncommission@cftc.mw
Website: www.cftc.mw

The information in this document is for general guidance only. It does not constitute legal advice and should not be relied upon as a statement of law relating to the Competition and Fair Trading Act ('the Act'). Obtain legal advice if you are not sure whether a merger transaction may breach the Act.

JANUARY 2015

Table of Contents

1.0 Introduction....................2
2.0 Relevant Legal Provisions....................3
3.0 Why Mergers are regulated under the Competition and Fair Trading Act?....................4
4.0 Types of mergers....................4
4.1 Horizontal mergers....................4
4.2 Vertical mergers....................5
4.3 Conglomerate mergers....................6
5.0 Mergers subject to the Act?....................6
6.0 Notification and Commission's consideration of merger applications....................7
6.1 Merger application....................7
6.2 Period for submitting a merger application to Commission....................8
6.3 Who should submit an application for authorisation of a merger?....................9
7.0 Assessing the competitive effects of a Merger....................9
7.1 Legal basis....................9
7.2 Public Hearing.................... **Error! Bookmark not defined.**
7.3 Decision of the Commission....................13

1.0 Introduction

Mergers and acquisitions have increasingly become an important form of investment and they aid the efficient functioning of the economy. Through mergers and acquisitions firms are able to achieve efficiencies, such as economies of scale or scope, and diversify risk across a range of activities. They also provide a mechanism for resuscitating ailing firms.

Despite having advantages mergers may create conditions which may result in consumer detriment. In the vast majority of mergers, sufficient competitive tension remains after the merger which ensures that consumers and suppliers are no worse off. In many cases mergers create benefits for consumers or suppliers. However, in some cases mergers have anti-competitive effects. By altering the structure of markets and the incentives for firms to behave in a competitive manner, some mergers can result in significant consumer detriment.

This is the concern of the Competition and Fair Trading Act (the Act). Section 35 of the Act prohibits consummation of any merger that has the effect or is likely to have the effect of substantially lessening competition in any market in Malawi unless authorized by the Commission. Therefore, the Act under Section 36 provides for parties to a merger to apply to the Competition and Fair Trading Commission (the Commission) for authorization of a merger. To determine whether a merger has the effect or the likely effect of substantially lessening competition, the Commission is mandated under Section 37 of the Act to assess mergers and on the basis of the results of the assessment authorize or not authorize them.

These guidelines have been developed to offer explanation on how the Commission enforces merger provisions of the Competition and Fair Trading Act. The guidelines offer insights into how the Commission assesses the legality of mergers. The purpose of the guidelines is to show the Commission's approach when reviewing mergers and the types of information which are relevant. They are intended to provide guidance for the business community, their advisers and the public generally.

It is important to note that merger assessment is case specific and therefore the assessment by the Commission takes account of the particular transaction and the markets being analysed. Therefore, these guidelines are not a prescriptive guide. The Commission considers each merger with due regard to the particular circumstances of the case, including the information available and the time constraints applicable to the case, and will apply these guidelines flexibly, departing from them where necessary.

The guidelines are informed by economic theory, legal thinking and international best practices applied in merger control. As markets, economic theory, legal thinking and best practices evolve; the Commission may revise the guidelines from time to time to reflect new developments.

2.0 Relevant Legal Provisions

2.1 The provisions of the Act relevant to merger control include:

2.1.1 Section 35 (1) which prohibits consummation of anti-competitive mergers. Specifically the Section states that:

'*any person who, in the absence of authority from the Commission, whether as a principal or his agent, participates in effecting – (a) a merger between two or more independent enterprises; (b) a takeover of one or more such enterprises by another enterprise, or by a person who control another such enterprise, where such a merger or takeover is likely to result in substantial lessening of competition in any market shall be guilty of an offence.*'

2.1.2 Section 2 of the Act defines a merger as:

(a) The acquisition of controlling interest in –
(i) Any trade involved in the production or distribution of any goods and services;
(ii) An asset which is and may be utilised for or in connection with the production or distribution of any commodity, where the person who acquires the controlling interest has already a controlling interest in any undertaking involved in the production or distribution of the same goods and services; or

(b) Acquisition of controlling interest in any trade whose business consists wholly or substantially in:
(i) Supplying goods and services to the person who acquires the controlling interest;
(ii) Distribution of goods or services produced by the person who acquires the controlling interest.

2.1.3 Section 36 states that '*Any person may apply to the Commission for an order authorizing that person to effect a merger or takeover*.'

2.1.4 Section 37 mandates the Commission to investigate any application for authorization of a merger and gives powers to the Commission to require any person with relevant information to provide such information to the Commission for assessment of the merger.

2.1.5 Section 38 of the Act provides for the criteria for evaluating application for authorization by the Commission.

2.1.6 Section 39 provides that the Commission should issue an order approving or rejecting a merger within 45 working days.

2.1.7 Section 40 provides for the enforcement of the order issued by the Commission in respect of a merger application.

2.1.8 Other relevant Sections are:

- Section 2(5) which stipulates factors to be considered in assessing effect of a conduct on competition.
- Section 8 outlines the functions of the Commission which include taking necessary action to prevent or redress the creation of a merger or the abuse of a dominant market position.
- Section 10 which deals with powers of the Commission for the performance of its functions. Sub-section 10(2) mandates the Commission, where it deems necessary, to hear orally any person on any case brought before it.
- Section 11 requires that the hearing by the Commission be in public unless circumstances require a private hearing.

3.0 Why Mergers are regulated under the Competition and Fair Trading Act?

3.1 Mergers and takeovers are regulated under the Act because they have the potential to lessen competition by altering market structure (reducing number of players) or creating market power by the merging parties or inciting other enterprises in the market to engage in anti-competitive conduct (uncoordinated effect). In short mergers may lead to infringement of the provisions of the Competition and Fair Trading Act by:

- Reducing number of competitors in a market leading to reduction in market concentration. In this regard, the concern is that the merging parties will, after the merger, have the incentive and ability to unilaterally worsen their competitive offers as a result of the loss of the rivalry between them. The deterioration in competition between the firms may take the form of a price increase (by one or both parties to the merger) and/or lower product quality or service, reduced innovation, or some other dimension along which the firms compete;
- Creation of market power which can be abused such as by foreclosing the market for new entrants or for existing firms to compete effectively; and
- Creating conditions for coordinated behavior (tacit collusion).

3.2 Therefore, the core purpose of merger review as provided for under Section 38 of the Act is to ensure that mergers and takeovers do not lead to harm to consumers (or customers, where products or services are not directly sold to end-consumers).

4.0 Types of mergers

4.1 Horizontal mergers

4.1.1 A horizontal merger is one between parties that are competitors at the same level of production and/or distribution of a good or service. Horizontal mergers may result in elimination of rivalry between the overlapping activities of the merging parties and therefore lead to loss of competition.

4.1.2 Horizontal mergers may enable merging parties realize efficiency gains and in some circumstances this may intensify rivalry and be beneficial for consumers. However horizontal mergers raise competition concerns through:

(a) Unilateral effects – which arise where, as a result of the merger, competition between the products of the merging firms is eliminated, allowing the merged entity to *unilaterally* exercise market power, for instance by profitably raising the price of one or both merging parties' products, thus harming consumers.

(b) Coordinated effects which arise where the merger increases the probability that, post-merger, merging parties and their competitors will successfully be able to coordinate their behaviour in an anti-competitive way, for example, by raising prices. The main concern, here, is whether the merger will create or strengthen certain market conditions which allow firms in the market (not only the merged entity) to successfully coordinate their actions to the disadvantage of consumers (or customers).

4.2 Vertical mergers

4.2.1 Vertical mergers are mergers between firms that operate at different but complementary levels in the chain of production (e.g., manufacturing and an upstream market for an input) and/or distribution (e.g., manufacturing and a downstream market for re-sale to retailers) of the same final product. In purely vertical mergers there is no direct loss in competition because the parties' products are not substitutes. Therefore, vertical mergers do not result in change in the level of market concentration.

4.2.2 Vertical mergers have significant potential to create efficiencies largely because the upstream and downstream products or services complement each other. Despite having this advantage, vertical mergers may raise competition concerns. A key concern by the Commission with vertical merges is whether the merger will lead to market foreclosure i.e. whether the merge will force rivals exit the market, raise their costs levels or raise barriers to entry in a manner

that lessens competition. Vertical mergers can also lead to coordinated effects.

4.3 Conglomerate mergers

4.3.1 Conglomerate mergers involve firms that operate in different product markets, without a vertical relationship. They may be product extension mergers, i.e., mergers between firms that produce different but related products or pure conglomerate mergers, i.e., mergers between firms operating in entirely different markets. Conglomerate mergers do not entail the loss of direct competition between the merging firms. They may, however, result is market foreclosure under some conditions.

5.0 Mergers subject to the Act?

5.1.1 Section 35 provides that mergers and takeovers that are likely to result in substantial lessening of competition are prohibited unless authorized by the Commission. Section 2(1) of the Act defines a merger as acquisition of **controlling** interest in an enterprise. Therefore, whenever a firm acquires controlling interest in another firm, such an acquisition raises the interest of the Commission to know the likely impact of such a transaction on competition in the market where the merger has taken place.

5.1.2 For the Commission to determine whether a merger would likely result in substantial lessening of competition, it is required to conduct an assessment of the proposed merger taking into consideration all factors that affect competition (see Section 2(5)). Accordingly, Section 36 of the Act provides that parties (jointly or one of the parties) or indeed any person authorized by the parties may apply to the Commission for authorization of a proposed merger. The process of submitting an application for authorization to the Commission is commonly known as **Notification** and involves the parties providing information to the Commission about the nature of the transaction and details about the parties to the proposed merger in a proscribe form.

5.1.3 The Act does not provide for thresholds that qualify a merger to be notified to the Commission. This essentially, means that any merger which results in change of controlling interest in a firm is subject to notification to the Commission. The submission of an application to the Commission for authorization of a merger (notification) does not necessarily mean that the merger being notified has been presumed to likely result in substantial lessening competition. The notification is simply meant to enable the

Commission conduct an assessment to determine whether a proposed merger would likely result in substantial lessening of competition or not.

5.1.4 It is important to note that mergers consummated outside Malawi involving firms that either the target firm or both parties have physical presence in Malawi are subject to notification under the Competition and Fair Trading Act.

5.1.5 The Act acknowledges that not all mergers would likely result in substantial lessening of competition. This is why the wording of Section 36 which requires parties to apply for authorization of mergers is voluntary. However, if a merger has not been voluntarily notified to the Commission by the parties and the Commission suspects that the merger may likely result in substantial lessening of competition, the Commission may invoke the powers vested in it by Section 8(2)(c) of the Act and require parties to notify the merger.

5.1.6 Voluntary notification of a merger has some advantages. It ensures that the Commission is served with detailed information necessary for a proper analysis of the merger at the earliest opportunity and if the Commission has some concerns about the merger, the parties can take necessary remedial measures to address the concerns before the merger is consummated.

6.0 Notification and Commission's consideration of merger applications

6.1 Merger application

6.1.1 Parties to a merger may apply for authorization using a prescribed form (Form No. CFTC/VI) which is attached to the Competition and Fair Trading Regulations. In the form, parties are required to provide information necessary for the Commission to carry out an assessment of the merger. If the parties feel that they need to provide additional information which is not provided for in the form, they are encouraged to attach such information to the form. The information may include reports of relevant studies that have been conducted by the parties or third parties.

6.1.2 The Commission encourages parties to contact the Commission before submitting an application for guidance. In these contacts the Commission provides information to the Parties on notification procedures as well as advising them how to structure the merger so that it does not raise possible competition concerns. Based on these consultations, the Commission may issue a letter of comfort to parties where the information provided by the parties does not suggest that a merger may likely raise competition concerns.

6.1.3 Parties may apply for an assessment of a merger under negative clearance procedure where they are of the view that such a merger would not limit access to markets; unduly restrain competition; or have or likely to have adverse effect to trade or the economy in general. However, parties are advised to contact the Commission before submitting an application for negative clearance to confirm whether the merger should be cleared under negative clearance procedure or not.

6.1.4 Negative clearance for mergers is an abbreviated merger assessment procedure which mostly relies on information provided by the parties and limited desk research and stakeholder consultations. The procedure is applied where the Commission needs to verify whether the merger would not likely lessen competition.

6.1.5 The assessment under negative clearance procedure is mostly less rigorous. However, if the Commission establishes that the merger has serious competition concerns after receiving a negative clearance application, it shall require the parties to make a full merger notification with the necessary fees payable.

6.1.6 An application for merger authorisation has to be accompanied by latest audited financial accounts and a payment of notification fees. The notification fee is 0.05% of combined turnover or total assets, whichever is the higher, of the enterprises proposing to effect the merger or takeover. The Commission does not consider an application complete until a payment of notification fees is received and all the necessary information is submitted. For negative clearance the fee is MK 700,000.

6.1.7 The application can be submitted electronically followed by submission of hard copies. The Commission will not process applications unless hard copies of the application have been received and all the necessary information is received.

6.2 Period for submitting a merger application to Commission

6.2.1 The Act does not provide for a timeframe for parties to lodge an application for authorization of a merger to the Commission. There is, therefore, no formal requirement for parties to submit an application for authorization of a merger before closure of the transaction. In this regard, the Commission entertains applications for authorization of mergers before as well as after closure. When notification is to be made after closure, it is instructive that it should be done without undue delays otherwise the parties risk consummating a merger in contravention of Section 35.

6.3 Who should submit an application for authorisation of a merger?

6.3.1 According to Section 36 of the Act any person may apply to the Commission for authorisation of a merger. It could be any one of the parties or both parties making a joint notification. If the application is made by a person other than the parties, the Commission requires the person making the application to produce proof of authority from the parties.

7.0 Assessing the competitive effects of a Merger

7.1 Legal basis

7.1.1 In assessing the competitive effects of a merger, the Commission is guided by Section 2(5) of the Act which provides that effect on competition should be determined with reference to all factors that affect competition in a market. The Commission is also guided by Section 38 of the Act which outlines the criteria for determining whether a merger should be authorized or not. In this regard, four questions are key to the assessment of the impact of a merger on competition in a market. These are:

(i) What is the relevant market;
(ii) Will the merger be likely to substantially lessen competition?
(iii) What efficiencies will the merger create? and
(iv) What other advantages or disadvantages to the industry, general public and the economy as a whole will the merger bring?

- **Market definition**

7.1.2 Identification of the relevant market is an integral part of the evaluation of the competitive effects of a merger. Market definition establishes the relevant 'field of inquiry' for merger analysis, identifying those sellers and buyers that may potentially constrain the commercial decisions of the merger parties and the merged firm, and those participants, particularly customers, that may be affected if the merger lessens competition.

7.1.3 In evaluating the likely effects of a merger on competition, an important first step is to define the market(s). Section 2(3) states that reference to the term market under the Act is a reference to a market in Malawi for goods and services that, as a matter of fact and commercial common sense, are substitutable for them. Implied in this statement is the fact that a market has two dimensions, namely: relevant product market and relevant geographical market. The product market refers to the products currently being bought or sold by the merging firms and any close substitutes for those products. The geographical market is the area within which buyers of the product could easily switch from one supplier to another. Considered in defining geographical market are issues like transport cost and regulatory barriers that would present buyers from switching from the product to other products. For example if distance would make a potential substitute products too

expensive for a buyer to switch to, that product may not be included in the relevant market for the merging firms' products.

7.1.4 The relevant market is defined as the smallest area over which a hypothetical monopolist (or monopsonist) can exercise a significant degree of market power. This would be possible only if all sources and potential sources of close substitutes for the merged firm's products have been included in the definition of the market.

- **Assessment of Substantial lessening of competition**

7.1.5 In applying the concept of substantial lessening of competition in a market, the Commission assesses the nature and extent of the market, the probable nature and extent of competition which would exist in the absence of the merger, the way the market operates and the nature and extent of the contemplated lessening. The determination of what constitutes substantial lessening of competition is a matter of judgment and will always depend on the particular facts of the merger under investigation. Where there is a reasonable likelihood that prices in the relevant product market would be maintained at a significantly greater level than they would be in the absence of the merger, or where competitive outcomes would otherwise be distorted, the Commission shall consider there to be a substantial lessening of competition.

7.1.6 In evaluating whether a merger is likely to have the effect of substantially lessening competition in a relevant market, the Commission considers the following non-exhaustive list of 'merger factors':

(i) the actual and potential level of import competition in the market;
(ii) the height of barriers to entry to the market;
(iii) the level of concentration in the market;
(iv) the degree of countervailing power in the market;
(v) the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins;
(vi) the extent to which substitutes are available in the market, or are likely to be available in the market;
(vii) the dynamic characteristics of the market, including growth, innovation and product differentiation;
(viii) the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor;
(ix) the nature and extent of vertical integration in the market.

7.1.7 In assessing market concentration the Commission may consider the following factors:

(i) Market shares of firms in the market;
(ii) Number of firms in the market;

(iii) Concentration ratios; and
(iv) The Herfindahl-Hirschman Index ("HHI").

7.1.8 In measuring market concentration the Commission may use sales revenue, production volume, capacity or reserves to measure market concentration. The measure the Commission will use shall depend on the facts of the case and the availability of information.

7.1.9 A merger will less likely be found to substantially lessen competition if the combined market share of the merging parties post-merger is less than 40% for horizontal mergers and less than 30% for non-horizontal mergers. Note that these thresholds may be used as an initial indicator of the absence of competition concerns and shall not give rise to a presumption of either the existence or the absence of such concerns.

7.1.10 When concentration ratios are used, a merger would be less likely to be found to substantially lessen competition if the CR3 is less than 65%. The concentration ratio accounts for the percentage of total industry output (or other such measure of economic activity e.g. turnover) which a given number of large firms account for.

7.1.11 When assessing the HHI the Commission will be less likely to identify:

(i) Horizontal competition concerns where the post-merger HHI is between 1000 and 2000 and a delta below 250, or above 2000 and a delta below 150, except where special circumstances are present; and
(ii) Non-horizontal competition concerns where the post-merger HHI is below 2000.

- **Assessment of efficiencies of a merger**

7.1.12 Section 38 requires the Commission to consider advantages and disadvantages to be created by a merger in its assessment. A merger is considered advantageous if it results in:

(a) A substantially more efficient unit with lower production or distribution costs;
(b) An increase in net exports;
(c) An increase in employment;
(d) Lower prices to consumers;
(e) An acceleration in the rate of economic growth; and
(f) A more rapid rate of technological advancement by enterprises in Malawi.

7.2 Time

7.2.1 A merger assessment is a fully fledged investigation. It is both a consultative and legal process. Section 39 or the Act provides that the Commission should make its Order within forty-five days. However, the counting of the days shall only be valid in the event that both parties have submitted complete information. In the event that the parties have submitted incomplete information, section 10(1)e shall apply (ie. The investigation shall be adjourned), and the stop clock provision shall apply.

7.2.2 A Comfort Letter is normally issued upon request by the parties who may wish to satisfy some contractual or regulatory requirements. This is not an approval by the Commission, however , it is a result of a preliminary assessment from the Commission that we have a vague idea of the outcome of the transaction , and that , should there be any adverse outcome, some remedies are available to mitigate any harm to competition that the merger may bring. It is acceptable and common practice to issue a letter of comfort, however, the Commission will not make a decision on the merits of the application at this stage. The comfort letter allows the parties to engage in the subject conduct as if it had authorization while providing the Commission space to consider the substance of the merits of the application

7.3 Provisional Findings of the Investigations

7.3.1 Provisional findings of the investigations will be published within 45 days and shared with the parties concerned. Parties will be required to sign a confidentiality undertaking before they access the Report of which contains provisional findings of the investigation. Sometimes cases may take longer as the Commission may adjourn investigations from time to time in line with section 10 (1) e of the Act, based on delay in submission of crucial information or evidence. Upon publication of the provisional findings, the Respondent is at liberty to request a negotiated settlement. Alternatively, the Respondent may request a public hearing before the Technical Committee of the Commission. The current standard practice is to hold Public Hearings for all cases, especially where there is a factual dispute.

8.0 During a public hearing, the parties are allowed to present their case on their own or through a legal counsel.

9.0 After the public hearing, a report shall be produced providing a record of the proceedings.

9.1.1 Where the decision of the Commission is going to be adverse to the parties, the Commission shall organize a public hearing for the parties and interested

parties to be orally heard by the Commission. The staff paper on the merger shall be made available to the parties prior to the hearing to enable them to prepare their presentation to the Commission.

9.2 Decision of the Commission

9.2.1 The Commission is required not to authorise a merger unless on a balance its advantages outweigh the disadvantages.

9.2.2 The Secretariat investigates and analyses application for authorization of a merger and prepares a staff paper that details out its findings and submit the report the Commission for consideration. The Commission can approve the recommendations in the Staff Paper or deviate from the recommendations. The decision of the Commission shall be communicated to the parties as well as stakeholders. The general public shall also be informed through a press release or press interview by the Chairperson of the Commission.

9.2.3 Any person including the Parties may appeal against the decision of the Commission within fifteen days of making the decision if they are dissatisfied with the decision in a court of law. The court may confirm, modify or reverse the findings of the Commission or direct the Commission to reconsider its decision in whole or part.

A full text of the Act is available on our webpage http://www.cftc.mw

For more information, contact

The Executive Director
Competition and Fair Trading Commission
1st Floor Mpikisano House
Off Mandala Road
Private Bag 332
Lilongwe
Tel: +2651759506/7;
Fax: +2651759522;
Email: competitioncommission@cftc.mw