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Implications of the Smallness of an Economy for Merger Remedies

There has been increasing discussion in recent years concerning the particularities of small economies in the context of competition law and policy.*[1] It has been generally recognised that market structures in small economies tend to be more concentrated than market structures in large economies, where economies of scale and scope are important. There have been voices arguing that such features may call for specifically tailored competition rules.*[2]

This article studies the implications related to the small size of an economy for merger control and, in particular, remedies applicable in merger control. The article questions whether the principles applicable to the use of merger remedies in large economies are equally appropriate in small economies.

In order to seek an answer to this question, section 1 of this article first discusses in brief the effects of the smallness of an economy on competition, pointing to some factors that tend to cause distinct outcomes in small economies, such as high concentration rates and entry barriers. Section 2 of this article deals with remedies applicable in the case of anti-competitive (illegal) mergers, first giving a brief overview of some procedural considerations related to merger remedies, the different types of remedies applicable in merger control, and the principles for the choice of remedies in various competition regimes. Thereafter, it discusses the justification for wider use of behavioural remedies in small economies, as compared to large economies, coupled with various case studies. Finally, some conclusions follow.

It should be noted at the outset that, even though there are various ways to define smallness of an economy, for the purposes of this article economies whose population is below 10 million are considered small. Setting of any such dividing line is a rough decision, and as the threshold for smallness is moved up or down, the weight of the various arguments concerning the particularities of small economies changes — the specific

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1 OECD Global Forum on Competition. Small Economies and Competition Policy: A Background Paper. – CCNM/GF/COMP(2003)4, February 2003. Available at http://www.oecd.org/dataoecd/57/57/2486546.pdf (30.07.2008) (hereinafter: OECD Background Paper); M. Gal. Size Does Matter: The Effect of Market Size in Optimal Competition Policy. – Southern California Law Review, September 2001, pp. 1437–1478; L. Evans, P. Hughes. Competition Policy in Small Distant Open Economies: Some Lessons from the Economics Literature. – New Zealand Treasury Working Paper 03/31, December 2003. Available at http://www.treasury.govt.nz/publications/research-policy/wp/2003/03-31/twp03-31.pdf (30.07.2008); H. Horn, J. Stennek. The Political Economy of EU Merger Control: Small vs. Large Member States. 21.09.2005. Available at http://www.econ-law.se/Papers/Horn-Stennek-revised.pdf (30.07.2008); Competition, Regulation and Development Research Forum (CDRF). Competition and Regulatory Regimes in Small & Developing Countries. – Policy Brief 2/07. Available at http://www.circ.in/pdf/PolicyBrief2.pdf (30.07.2008); Competition Law Forum. Small Economies and Competition Policy — A Fair Deal? Summary of conference presentations and discussions. Luxembourg, October 2007. Available at http://www.eventsforce.net/OXYGEN/media/uploaded/EVOXYGEN/event_82/Small%20Economies%20Conference%20-%20Summary%20transcript.pdf?popup=1 (30.07.2008).

2 *Ibid.*

features associated with smallness grow progressively more apparent the smaller the nation and less apparent the closer the size of the nation is to the threshold.

1. Effects of smallness on competition

One of the most widely recognised effects of smallness of an economy is the difficulty of achieving minimum efficient scale (MES) for domestic firms, on account of low domestic demand. As Michal S. Gal has put it, "[t]he basic handicap resulting from small size is the need to produce at levels that cater to a large portion of demand in order to achieve minimum costs of production".*3 Therefore, small economies can support only a small number of competitors in many industries, which is why their markets tend to be highly concentrated.*4

In many cases, the problem of smallness of domestic markets can be mitigated by opening the markets to trade — foreign markets can broaden the sources of demand and increase the potential for actualising the expansion that is necessary for achieving MES, by exploiting economies of scale and scope. At the same time, imports can supplement or replace lacking domestic production. This means that where domestic production is too costly or impossible because of the problem of achieving MES or on account of scarcity or lack of resources, import goods could satisfy the demand in small economies.*5

The benefits of trade have been recognised around the world, and, with respect to many goods; this has greatly alleviated the problems of achieving MES domestically and has opened up many domestic markets to competition from foreign firms as well. As a result, the majority of markets in small, open economies are composed, solely or to a great extent, of imported products; and the number of markets that are solely or mostly supplied by domestic products is rather limited.*6

However, even in the case of the most liberal trade regulations, barriers to trade may still exist. Therefore, an economy's openness to trade cannot fully resolve the problems related to small size in every industry. This is because of the existence of irremovable barriers to trade, such as natural barriers (e.g., oceans, mountains, and large distances), cultural or language differences, consumer preferences, and high transportation costs.*7 The effect of such factors on trade depends greatly on the nature of the goods or services.*8 For instance, perishable goods (such as fresh milk products and fresh bakery products) that have a short storage life can be traded only within limited distances. Similarly, trade is unlikely where the value-to-weight or value-to-size ratio of the goods in question would render transportation irrational on account of high costs.*9 Other factors, such as consumer preferences, culture, and language differences can complicate trade as a consequence of the need to customise the goods for the target market or of the need to break the established brand loyalty with respect to domestic products.*10

Such obstacles to trade are likely to cause proportionally more significant segmentation in certain economies than in others. The more distant the economy is from its potential trade partners either naturally or culturally, the higher are the barriers to trade and the larger is the number of non-tradable sectors. Furthermore, an economy being of small size may discourage trade, because the investment costs of adapting to local consumer preferences or language requirements are proportionately higher as compared to those in large economies. Therefore, small and/or distant economies will always be more prone to face problems of achieving MES, particularly with respect to non-tradable goods and those goods that face significant trade barriers.

Furthermore, smallness of an economy could constitute a factor raising entry barriers for potential market participants. Since the demand in small markets is limited, certain kinds of entry barriers, such as lack of economies of scale and scope, are likely to be harder to overcome in small economies than in large ones. This is because an entrant with plants of less than MES would face cost disadvantages *vis-à-vis* firms with MES plants. It has been reasoned that if MES is large relative to demand and if the cost penalties for operating below MES are substantial, a new firm would have to enter the market at such a large scale that the combined output of all firms operating in the market could be sold only at substantially reduced prices, perhaps even below average

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3 M. Gal (Note 1), pp. 1439–1441.

4 See, e.g., M. Gal. Competition Policy in Small Economies — Prepared Remarks for the OECD Session on Small Economies. – CCNM/GF/COMP/WD(2003)42, February 2003. Available at http://www.oecd.org/dataoecd/57/28/2486919.pdf (30.07.2008); H. Horn, J. Stennek (Note 1); Competition law forum (Note 1); OECD Background Paper (Note 1).

5 OECD Global Forum on Competition. Estonia — Competition Problems in a Small Country. – CCNM/GF/COMP/WD(2003)5, January 2003. Available at http://www.oecd.org/dataoecd/57/44/2486151.pdf (30.07.2008).

6 *Ibid*.

7 M. Monti. Market Definition as Cornerstone of EC Competition Policy. Speech/01/439, Workshop on Market Definition, Helsinki Fair Centre, October 2001. Available at http://ec.europa.eu/comm/competition/speeches/ (30.07.2008).

8 H. Horn, J. Stennek (Note 1), pp. 7–9.

9 *Ibid.*

10 M. Monti (Note 7).

total cost, unless one of the firms exits the market.[*11] Moreover, a small market can be unattractive also simply because of the maximum potential total return on investment being smaller than that in large markets.

Small size may also create more competition problems if the existing competitors control concentrated, vertically-linked markets. In particular, the existence of high MES levels in one market might limit entry into a vertically-linked market if it requires a new entrant to enter more than one market in the chain of manufacturing and distribution, or if it significantly raises that entrant's costs relative to the costs of its rivals.[*12] Such impediment can be both structural and strategic in nature.[*13]

With MES considerations left to the side, limited human resources can also constitute an entry barrier, since small population size often constrains the availability of human capital, especially skilled labour. Furthermore, most small economies are also small in geographic terms, which tends to entail a limited and less diversified supply of natural, irreproducible resources.[*14]

Such problems are exacerbated to the extent that domestic regulations inhibit rather than enhance competition. For example, the existence of country-specific distribution regulations could constrain market entry. Thus, it is of particular importance for small economies to ensure the openness of distribution systems and not maintain regulations favouring the existing market participants.[*15] In sectors where competition is severely limited, regulation targeted at loosening the ties present between various existing market participants may be needed to limit the potential costs imposed by the presence of market power.[*16] As will be seen below, in the case of mergers that are potentially anti-competitive, remedies can be applied for such regulation.

2. Remedies in the case of anti-competitive mergers

2.1. Overview of some procedural considerations related to merger remedies

Whenever a merger would have serious anti-competitive effects, it is usually deemed illegal in all jurisdictions where merger control is in force. Depending on the procedural arrangements (either a pre-merger notification system or post-merger assessment), the competition authority investigating such a merger is tasked with prohibiting the merger or declaring its illegality in order to avoid detriment to competition.[*17]

Alternatively, most jurisdictions allow modifications to be made in the merger arrangements in order to remove or at least mitigate the competition concerns raised by the merger; i.e., remedies are applied. Such modifications constitute commitments by the merging parties to fulfil certain obligations or achieve certain outcomes, such as to divest some assets or businesses, or to act in a specified manner. The competition authority's approval of the merger could be made conditional on compliance with such requirements, or a fine could be specified for the case of non-compliance.[*18]

The aim of the remedies is to avoid prohibiting the merger transaction as a whole while at the same time remedying the loss of free competition and diminishing the potential harm to competition. As it is in the interests of the merging parties to avoid the prohibition of their contemplated merger, it is usually up to them to propose adequate modifications. Depending on the procedural rules, such modifications can be made as amendments to the merger notification submitted by the merging parties, as additional proposals by the merging parties, or as a result of negotiations between the merging parties and the competition authority.[*19]

11 M. Gal (Note 1), p. 1445.

12 *Ibid.*, p. 1448.

13 See more on the distinction of structural and strategic trade barriers from OECD Policy Brief. Competition and Barriers to Entry. January 2007. Available at http://www.oecd.org/dataoecd/9/59/37921908.pdf (30.07.2008).

14 *Ibid.*, p. 1447.

15 OECD Global Forum on Competition. Denmark — Special Aspects of Competition Policy in Small Economies. – CCNM/GF/COMP/WD(2003)16, January 2003, p. 2. Available at http://www.oecd.org/dataoecd/58/26/2485941.pdf (30.07.2008); OECD Global Forum on Competition. Ireland — Special Aspects of Competition Policy in Small Economies. – CCNM/GF/COMP/WD(2003)18, January 2003, p. 4. Available at http://www.oecd.org/dataoecd/58/8/2485758.pdf (30.07.2008); OECD Global Forum on Competition. Malta — Competition Policy in Small Economies. – CCNM/GF/COMP/WD(2003)32, January 2003, p. 7. Available at http://www.oecd.org/dataoecd/57/8/2486833.pdf (30.07.2008); OECD Global Forum on Competition. Switzerland — Special Aspects of Competition Policy in Small Economies. – CCNM/GF/COMP/WD(2003)18, January 2003, p. 4. Available at http://www.oecd.org/dataoecd/58/22/2486055.pdf (30.07.2008).

16 OECD Global Forum on Competition. New Zealand — Competition Policy in Small Economies: Issues Arising. – CCNM/GF/COMP/WD(2003)29, January 2003, p. 7. Available at http://www.oecd.org/dataoecd/57/53/2486698.pdf (30.07.2008).

17 Author's conclusion on the basis of the data available in The Global Merger Control Manual. 7th edition. D. J. Laing, L. A. Gomez (eds.). Cameron May, 2007.

18 *Ibid.*

19 *Ibid.*

Where the enforcement of remedies imposed in a merger authorisation requires monitoring, independent trustees or experts are sometimes used in some jurisdictions to oversee the parties' compliance with the obligations imposed. The costs of hiring the trustees are normally borne by the parties, as it is in the parties' best interests, in order to avoid prohibition of the merger, to provide the competition authority with sufficient assurance that the commitments are going to be complied with and to minimise the competition authority's monitoring costs.[*20]

2.2. Types of remedies

Remedies are typically classified into two broad categories — structural and behavioural. Structural remedies are those that are designed to make changes to the structure of the market, whereas behavioural remedies regulate the conduct of the merging parties after the merger.

The most typical structural remedy is divestiture of a business, a set of assets, or productive capacity. The aim of such a remedy is to create or strengthen a source of competition to the merged entity in order to restore or maintain competition in the relevant market after the merger. In addition to divestiture, long-term and exclusive licensing of intellectual property rights and removal of links with competitors are considered structural.

Other remedies are typically considered behavioural. Such remedies may be targeted to deal with varying competition concerns. Firstly, there are measures aimed at facilitating horizontal rivalry. Such remedies may be designed to

(i) prevent the merged entity from using its horizontal market position to foreclose the market and lessen competition (e.g., commitments not to engage in tying, predatory pricing, or exclusive and long-term agreements);

(ii) prevent the merged entity from using its vertical integration to distort or limit horizontal rivalry (e.g., commitments to grant access to key infrastructure on regulated price and other terms); and

(iii) change buyers' behaviour in order to encourage competition (e.g., commitments to provide information to buyers and facilitate the process of switching providers).[*21]

Secondly, there are measures aimed at preventing exploitative behaviour on the part of the merged entity after the merger by controlling its outcomes. Such remedies include price caps, service level agreements, and supply or purchase commitments.[*22]

Some of the behavioural remedies may entail some structural effect on the market (e.g., granting access to infrastructure), while others are purely behavioural and may not in fact amount to more than a promise not to abuse market power. Often packages including different types of remedies are used. For instance, behavioural remedies may be necessary to supplement structural remedies in the interim between the adoption of the decision to authorise the merger and the completion of the divestiture. Similarly, there might be a package of various behavioural remedies.

As is apparent from the discussion above, the range of remedies is rather wide. However, legal rules and principles of individual legal systems, as well as declared enforcement policies, may pose conditions and limits as to the range of remedies available to the merging parties in a particular competition regime. An overview of such considerations is given below.

2.3. Principles of the choice of remedies in various competition regimes

Both the US and the EU merger control systems have clearly declared a preference for structural remedies. It is stated in the US Department of Justice Antitrust Division's 'Policy Guide to Merger Remedies' that "[s]tructural remedies are preferred to conduct remedies in merger cases because they are relatively clean and certain, and generally avoid costly government entanglement in the market".[*23]

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20 See, e.g., ICN Merger Working Group, Analytical Framework Subgroup. Merger Remedies Review Project – Report for the 4th ICN annual conference, Bonn, June 2005, pp. 14–15. Available at http://www.internationalcompetitionnetwork.org/media/library/conference_4th_bonn_2005/Remedies_Study.pdf (30.07.2008).

21 *Ibid.*, pp. 11–12 and 17–18. .

22 *Ibid.*, pp. 12 and 18–19.

23 US Department of Justice (DOJ) Antitrust Division. Policy Guide to Merger Remedies, October 2004, section 3.A. Available at http://www.usdoj.gov/atr/public/guidelines/205108.htm (30.07.2008). Similarly, the Statement of the Federal Trade Commission's Bureau of Competition on Negotiating Merger Remedies, 2 April 2003 (available at http://www.ftc.gov/bc/bestpractices/bestpractices030401.shtm (30.07.2008)) sets forth a similar principle.

In the EU, the European Commission's draft notice on remedies indicates that "commitments which are structural in nature, such as the commitment to sell a business unit, are, as a rule, preferable from the point of view of the [Merger Regulation], inasmuch as such commitments prevent, durably, the competition problem which the Commission considers would be caused by the merger as notified, and do not, moreover, require medium or long-term monitoring measures. Nevertheless, the possibility cannot automatically be ruled out that other types of commitments may also be capable of preventing the significant impediment of effective competition."*[24] The European Commission has stated its willingness to accept remedies that do not amount to more than purely behavioural promises only in exceptional circumstances, such as in respect of competition concerns arising in conglomerate structures.*[25]

Structural remedies are generally considered preferable also in the German*[26] and UK*[27] merger control systems.

Similarly to large merger control systems, various smaller systems give preference to structural remedies. For example, in New Zealand the Commerce Commission can only accept structural commitments to divest assets or shares and cannot accept behavioural commitments.*[28] In Slovenia, the standards for remedies are such that, even though behavioural remedies are not expressly excluded, they are unacceptable in practice.*[29] The working group set up by the Nordic competition authorities (including those of Finland, Sweden, Denmark, and Norway) has also expressed a preference for structural remedies.*[30] However, as will be seen from case studies presented below, they are still willing to adopt a flexible view toward behavioural remedies.

Conversely, there are several small economies wherein behavioural remedies are considered to be the preferred remedy. For instance, according to J. Amols, senior desk officer of the Latvian Competition Council, even though both structural and behavioural remedies are acceptable, the council considers purely behavioural remedies the most effective type of remedies, because remedies of this kind are less burdensome for merging parties and are also easier to control from the side of the council.*[31] Similarly, P. Gorecki, the director of the Mergers Division of the Irish Competition Authority, has expressed that "if there is a choice between a behavioural and a structural remedy the former is preferred".*[32] Behavioural remedies have so far played the primary role also in the merger control practice of Austria*[33], the Czech Republic*[34], Greece*[35], and Serbia.*[36] Below, a few examples of cases wherein behavioural commitments have been used in some of these jurisdictions are described.

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[24] Commission Notice on Remedies Acceptable under Council Regulation (EEC) No. 139/2004 and under Commission Regulation (EC) No. 802/2004 (draft), section 15. Available at http://ec.europa.eu/comm/competition/mergers/legislation/draft_remedies_notice.pdf (30.07.2008) (hereinafter: Commission's draft notice on remedies). Similar principles are declared in the currently valid Commission Notice on remedies acceptable under Council Regulation (EEC) No. 4064/89 and under Commission Regulation (EC) No. 447/98, section 9. Available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2001:068:0003:0011:EN:PDF (30.07.2008).

[25] Commission's draft notice on remedies, section 69.

[26] Section 40 (3) of the German Act against Restraints of Competition (available at http://www.bundeskartellamt.de/wEnglisch/download/pdf/06_GWB_7__Novelle_e.pdf (30.07.2008)) clearly prohibits the imposition of remedies requiring continued monitoring.

See also H. Bergmann, F. Röhling. Germany, in Getting the Deal Through: Merger Control 2008, question 22. Available at http://www.gettingthedealthrough.com/crossborder.php?region_id=16&sector_id=71 (30.07.2008).

[27] UK Competition Commission. Merger References: Competition Commission Guidelines, June 2003, paragraph 4.15. Available at http://www.competition-commission.org.uk/rep_pub/rules_and_guide/pdf/cc2.pdf (30.07.2008).

[28] A. Peterson, S. Keene. New Zealand, in Getting the Deal Through: Merger Control 2008, question 22. Available at http://www.gettingthedealthrough.com/crossborder.php?region_id=16&sector_id=71 (30.07.2008).

[29] Judgment of Administrative Court of Republic of Slovenia, Case No. U 1286/2003 of 18 June 2004 in Interbrew Central European Holding B.V., Pivovarna Laško d.d. and Pivovarna Union d.d. v. Competition Protection Office, cited through P. Pensa. Slovenia — Merger Control. – Competition Cases from the European Union. I. Kokkoris (ed.). London: Sweet & Maxwell 2008, pp. 1141–1152, paragraphs 25–042 and 25–051.

[30] Nordic Working Group. Commitments Concerning Concentrations between Undertakings, Summary of a Report from a Nordic Working Group 2003. Available at http://www.kkv.se/upload/Filer/ENG/Publications/koncentration_utsidan.pdf (30.07.2008).

[31] E-mail of J. Amols, Senior Desk Officer of the Latvian Competition Council, to the author, dated 29.02.2008.

[32] E-mail of K. MacGuill, Economist of the Irish Competition Authority to the author, dated 14.03.2008, forwarding the views of P. Gorecki.

[33] C. Vartian. Austria — Merger Control. – Competition Cases from the European Union. I. Kokkoris (ed.). London: Sweet & Maxwell 2008, paragraph 2-078. See also A. Reidlinger, A. Zellhofer. Austria. – Getting the Deal Through: Merger Control 2008, question 22. Available at http://www.gettingthedealthrough.com/crossborder.php?sector_id=71&region_id=36 (30.07.2008).

[34] Author's conclusion on the basis of Annual Reports 2000, 2001, 2002, 2003, 2004, 2005 and 2006 of the Czech Office for the Protection of Competition. Available at http://www.compet.cz/en/information-centre/annual-reports/ (11.05.2008). See also A. Bányaiová. Czech Republic, in Getting the Deal Through: Merger Control 2008, question 22. Available at http://www.gettingthedealthrough.com/crossborder.php?region_id=49&sector_id=71 (30.07.2008).

[35] A. Economou. Greece. – Getting the Deal Through: Merger Control 2008, question 22. Available at http://www.gettingthedealthrough.com/crossborder.php?region_id=17&sector_id=71 (30.07.2008).

[36] E-mail of D. Markovic-Bajalovic, President of the Serbian Commission for Protection of Competition, to the author, dated 7.03.2007.

In the case *Latvijas Mobilais Telefons/ZetCOM* (2007), concerning the merger of two Latvian mobile communication services providers, the Latvian Competition Council approved the merger, contingent on a range of behavioural commitments by the merging parties, including obligations to inform the customers about the merger, to maintain existing legal entities and brands until 2009, and to abstain from carrying out marketing measures especially aimed at attracting ZetCOM customers to the services of Latvijas Mobilais Telefons.*[37]

In *Airport Bratislava/Wien Flughafen AG* (2006), concerning the merger of the two national airport operators, the Austrian Federal Competition Authority authorised the merger after the parties undertook certain behavioural commitments pertaining to price caps, the capacity of the Vienna airport and the slots available there, and the unbundling (in accountancy terms) of airport infrastructure services vertically (with respect to other airport businesses) as well as horizontally (with respect to the two airports). Compliance with the commitments was to be monitored by trustees (an independent air traffic expert and an independent auditor).*[38]

In the 2002 *Agrofert Holding/Unipetrol* case, concerning the Czech market for nitrogen fertilisers, the Czech Office for the Protection of Competition accepted commitments of supply, of maintaining certain pricing conditions, and of making public announcements of price developments.*[39] In *Bijouterie Trading Company/Swarovski Bohemia* (2004), concerning the bijouterie markets, the authority accepted commitments to maintain open and fair demand for supplies.*[40]

2.4. Justifications for the wider use of behavioural remedies in small economies

2.4.1. Lack of enforcement power

As could be seen from section 1 of this article, in small economies many sectors are supplied by way of imported goods, and market participants often are owned by foreign companies. In such cases, the merger of foreign companies importing into or having subsidiaries in a small economy is likely to have effects on the competition conditions also there and would fall subject to control in such a small economy. In cases of cross-border mergers, particularly in the event of so-called foreign-to-foreign mergers, it may prove rather difficult for the competition authorities of small economies to take any effective enforcement actions undermining the merger or requiring compliance with burdensome conditions on the part of the merging parties.

The declaration of invalidity of a foreign-to-foreign merger would not have effects on the validity of the merger transaction if this transaction is legal in the home jurisdictions of the merging parties and under the laws chosen by the parties to apply for the transaction. Similarly, the threat of penalties would be unlikely to stop the foreign-to foreign merger, because of the lack of adequate enforcement measures. Even if the competition authority controlling a foreign-to-foreign merger could impose sanctions on the entities of the merging parties that are active in its jurisdiction or undermine the sales of the goods of the merging parties in its territory, it would risk causing the merging companies to leave the small economy all together, which might render the local consumers worse off.

The *Unilever/Ben & Jerry's* (2000) case from the practice of the Israel Antitrust Authority provides a good illustration of such circumstances. In 2000, US company Ben & Jerry's Homemade, Inc. and Anglo-Dutch company Unilever announced an agreement under which Unilever would acquire control over Ben & Jerry's.*[41] The merger was subject to control, *inter alia*, in Israel.

The Israel Antitrust Authority identified competition concerns in the Israeli ice cream market. The merger was cleared conditionally, after the parties undertook to distribute Ben & Jerry's ice cream in Israel through an independent distributor who would be free to determine the prices charged for the products. Moreover, the Israel Antitrust Authority required that the quality and quantity of the products be at least as high as it had been before the merger, and that any new product be made available to the independent distributor.*[42]

[37] Report on the Economic Development of Latvia, December 2007. Available at http://www.em.gov.lv/em/2nd/?cat=137&lng=en (30.07.2008).

[38] Annual Report on Competition Policy Developments in Austria 2005–2006. Available at http://www.bwb.gv.at/NR/rdonlyres/E459F1F0-439B-4B3C-8A8B-19C203B727C7/26202/Annualreport20052006final.pdf (30.07.2008).

[39] Press Release of Czech Office for the Protection of Competition of 4 September 2002: "Agrofert is allowed to acquire Unipetrol". Available at http://www.compet.cz/en/information-centre/press-releases/competition/agrofert-is-allowed-to-acquire-unipetrol/ (30.07.2008).

[40] Annual Report 2004 of the Czech Office for the Protection of Competition, p. 16. Available at http://www.compet.cz/en/information-centre/annual-reports/ (30.07.2008).

[41] Press Release of Ben & Jerry's Homemade, Inc. of April 16, 2000. Available at http://www.benjerry.com/our_company/press_center/press/join-forces.html (30.07.2008).

[42] Conditions for the approval of the merger between Ben & Jerry's Homemade Inc. and Unilever N.V, cited through M. Gal. Competition Policy for Small Economies. Cambridge, Massachusetts, London: Harvard University Press 2003, p. 246.

This case clearly illustrates the difficult trade-offs that the competition authorities of small economies often face in the event of foreign-to-foreign international mergers, as the actual choice of measures is rather limited. Had the merger been prohibited by the Israel Antitrust Authority, there would have been a great risk that, instead of withdrawing from the transaction, the merging parties would have simply chosen to cease their activities in Israel. This would have been even more detrimental for the Israeli consumers than an anti-competitive merger. As noted by Michal S. Gal, small economies are often left only to rely on the assumption that international firms will not change their strategic decisions (such as Ben & Jerry's introduction of new products to the world market in this case) only to reduce competition in the small economy.[*43]

In such cases, some local concerns can be mitigated via behavioural remedies. These remedies are less burdensome for the merging parties than are structural remedies; therefore, the merging parties may be more willing to agree to comply with the former than with the latter. Furthermore, behavioural commitments could be used to address the conduct directly affecting the small economy. Hence, in such circumstances the behavioural remedy might be the only remedy available to the competition authority in a small economy.

2.4.2. Preservation of efficiency gains and other benefits of a merger

Where a merger entails significant efficiency gains or other considerable public benefits, prohibition of the merger could be too stringent a remedy — in particular, where the anti-competitive effects would be outweighed by the positive effects. In such cases, structural remedies are usually the obvious choice for removing the competition problems. However, when divestitures are applied in small economies, they often imply a trade-off between enhancing competition and exploiting the potential cost-efficiencies that flow from achieving MES of production. Even if the merging entity could be broken up into smaller parts, market demand may set limits to the number of efficient units such that high concentration rates would prevail. Furthermore, structural remedies may not be effective without costly ongoing regulation after all, because (small) inefficient firms would not survive in a free market and would never grow to sizes large enough to allow them to take advantage of economies of scale.[*44]

Moreover, divestitures may be infeasible simply because there is no suitable package to be divested without interference with the remaining activities of the companies. This may be especially true where the total size and the range of business activities of the companies involved are rather limited. This problem is likely to have a greater effect in small economies — especially in new market economies, where private companies do not yet have a long history and their size is still limited.

Even where a suitable divestiture package exists, divestitures may not be a feasible solution because of the difficulty of finding a suitable purchaser that has no significant connection to the merging parties yet possesses sufficient resources, expertise, and incentives to operate the divestiture package as an effective competitor. In small economies, where the number of market players generally is limited, finding such a purchaser may prove rather difficult. In addition, because of particularities of specific market structures, structural remedies may not address all concerns fully.

The *Valio/Kainuu*, *Maito-Pirkka*, *Aito Maito* case, from the Finnish Competition Authority's practice, provides an example of such a situation. The case concerned the acquisition by a major Finnish dairy processor, Valio, of the dairy and marketing businesses of the co-operatives Maito-Pirkka and Kainuu and that of the company Aito Maito Fin Oy.[*45]

The Finnish Competition Authority assessed the effects of the acquisition in more than 20 product markets and found that the concentration would have resulted in the creation or strengthening of a dominant position in several of them. In the assessment of whether the concentration could be accepted, the central issue was how the purchase of raw material (raw milk) by Valio's competitors could be ensured.[*46]

The Finnish Competition Authority cleared the merger subject to an extensive package of remedies consisting primarily of behavioural remedies such as Valio's obligations to 1) sell to competitors annually a set amount of raw milk at prices equal to the average purchase price of Valio's own dairy industry, 2) make export purchases of raw milk as referred to in point 1 on the basis of market prices and reasonably non-discriminatory export costs, 3) offer logistics services to competitors and dairy processing and packaging services for the products referred to in point 1, and 4) sell to domestic customers all of the usual domestic milk powder brands manufactured by Valio at the market prices prevailing in the EU area. In addition, Valio was to sell some of

[43] *Ibid*.

[44] M. Gal (Note 1), p. 1469.

[45] Case No. 1151/81/1999 of 20.06.2000. Conditional approval of the acquisition: Valio Oy/Dairy and marketing businesses of Kainuu Co-operative, Maito-Pirka Co-operative and Aito Maito Fin Oy (Dnro. 1151/81/1999, 20.06.1999, Yrityskaupan hyväksyminen ehdollisena; Valio Oy/Kainuun Osuusmeijerin, Osuuskunta Maito-Pirkan ja Aito Maito Fin Oy:n meijeri- ja markkinointiliiketoiminnat). Available at http://www.kilpailuvirasto.fi/cgi-bin/suomi.cgi?luku=yrityskauppavalvonta/yrityskaupparatkaisut&sivu=ratk/r-1999-81-1151 (30.07.2008) (in Finnish).

[46] *Ibid*.

the acquired brands and offer the production plants or the related equipment for sale without any restrictions on use. An independent expert was appointed to monitor compliance with the commitments.*47

Because of the special features of the Finnish dairy market, divestitures of the brands and production plants alone would not have remedied the decrease in competition caused by the merger. The main impediment to competition encountered by Valio was the availability of raw milk and not production capacity, since Valio obtained the raw milk from co-operatives, which, in turn, purchased the raw milk from their producer members. As the co-operatives and producers were not parties to the acquisition, it was not possible to oblige them to deliver milk to Valio's competitors. In the event of prohibition of the transaction, the milk producers would have likely switched their supplies to Valio in due course and this would have created an even greater shortage in milk deliveries for the co-operatives to be acquired.*48

It appeared later that the few structural remedies attached to the merger did not produce the desired outcomes, as no competitor was interested in acquiring the brands or businesses to be divested.*49 However, the competitive concerns could be dealt with by means of the behavioural remedies — the transfer of raw milk to Valio's competitors was ensured with Valio's commitment to sell raw milk at Valio's own purchase price to the actual and potential competitors in the domestic market. Hence, Valio's competitors were able to balance out the decreased competition caused by the acquisition in the liquid milk market.*50

Thus, in the circumstances of limited availability of structural remedies, behavioural remedies can prove invaluable tools for securing positive effects for otherwise anti-competitive mergers.

2.4.3. Monitoring issues

Both structural and behavioural remedies require a certain degree of monitoring by the competition authority. This requires resources and expertise, which can be particularly limited in the case of small economies.*51

With respect to structural remedies, monitoring involves making sure that the divestiture or licensing is accomplished on time and with all due considerations as envisaged in the merger approval, as well as ensuring the viability of the business to be divested in the interim period between the competition authority's approval of the merger and the completion of the divestiture. As noted above, behavioural remedies could be used for that purpose, but this also requires monitoring resources from the competition authority. Even though the need for such monitoring is only short-term, it may pose more challenges and require more effort on the part of the competition authority than long-term monitoring of behavioural remedies would, especially since the need for intense monitoring of the divestiture process may be more unpredictable than is ongoing monitoring of conduct.

Moreover, the mistakes made in the process of divestiture are likely to have more detrimental effects than those made in the case of behavioural remedies, as divestitures are usually irrevocable and once the viability of a divestiture package has been shaken, its potential for success can be seriously undermined. At the same time, in the case of behavioural remedies, mistakes can in many cases still be rectified through further review of the commitments made by the merging parties. This is clearly demonstrated by the *A. Le Coq/Finelin* case, from the practice of the Estonian Competition Authority. The case raised competition concerns in the market for production and sale of cider in Estonia. The authority cleared the merger conditionally on the merging parties' compliance with production volume restrictions for a period of two years after the merger.*52 There was extremely rapid and unexpected growth in the Estonian cider market in the year following the merger, in view of which such harsh restriction turned out to be unnecessary. The limit was increased by the authority, further to the request of the merging parties.*53

The help of divestiture and interim trustees can be utilised to facilitate the divestiture process and alleviate the dangers. However, hiring a trustee can increase the costs of the transaction to unacceptable proportions for the merging parties, since the transaction values are often lower in small economies as compared to those of mergers in large ones, while the monitoring costs in the case of a divestiture are not necessarily so significantly lower in the case of mergers in small economies. Moreover, small economies often have limited human

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47 *Ibid*.

48 *Ibid*.

49 ICN Merger Working Group (Note 20), p. 37.

50 Yearbook 2001 of Finnish Competition Authority, pp. 28–30. Available at http://www.kilpailuvirasto.fi/tiedostot/vuosikirja-2001-englanti.pdf (30.07.2008).

51 OECD Background Paper (Note 1) paragraphs 32–34.

52 Decision No. 38-KO of 11.11.2003. Grant of permission to the concentration No. 22-ko/2003 AS A. Le Coq/OÜ Finelin (Otsus 11.11.2003 nr. 38-KO. Koondumisele nr. 22-ko/2003 AS A. Le Coq/OÜ Finelin loa andmine). Available at http://www.konkurentsiamet.ee/public/Koondumised/Arhiiv/ko200338.pdf (30.07.2008) (in Estonian).

53 Decision No. 27-KO, 24.08.2004. Amendment of conditions of the permission of the concentration No. 22-ko/2003 *AS A.Le Coq/OÜ Finelin* (Otsus 24.08.2004 nr. 27-KO. Koondumisele nr. 22-ko/2003 AS A. Le Coq/OÜ Finelin loa andmine kohustuse muutmine).

resources and expertise, as noted above. In this context, the know-how necessary for efficient enforcement of divestiture conditions may be lacking.

In the case of pre-merger notification, so-called 'fix-it-first' measures could be used; with this approach, the merging parties would be allowed to complete their merger only after the completion of the divestiture. This could also add incentives for the merging parties to arrange the divestiture expediently. However, 'fix-it-first' measures are not widely used, as they are very burdensome to the parties, since they involve delays that can be detrimental for the merger transaction.

With these considerations taken into account, greater reliance on behavioural remedies in some small economies could indeed be justified. However, the concerns related to behavioural remedies — in particular, the enforcement difficulties and the need for ongoing long-term monitoring — should be accorded serious weight in decision on whether to prohibit a merger or allow it only on condition of a bulky package of behavioural remedies.

The shortcomings of behavioural remedies are demonstrated by the Austrian case *Wrigley/Joyco*. The case concerned a foreign-to-foreign merger, whereby the US Wm. Wrigley Jr. Company, one of the world's leading chewing gum producers, would merge with Joyco Inversiones, S.A., which was part of the Spanish Corporación Agrolimen S.A. Wrigley and Joyco were the two biggest producers of bubble gum in Austria, and Wrigley had strong dominance in the chewing gum sector. The Austrian competition authorities had serious concerns about predatory portfolio effects related to the merger.[*54] Nevertheless, perhaps because this was a foreign-to-foreign merger, the Austrian Cartel Court approved the merger, conditionally on a behavioural commitment obliging Wrigley to maintain Joyco's brands in the market for bubble gum in Austria for the following two years in order to ensure product diversity. To specify the Joyco brands concerned, Wrigley submitted a product list to the Cartel Court. Two years later, the Austrian authorities found out that Wrigley had not complied with the remedy. This non-compliance triggered initiation of proceedings for fining Wrigley.[*55]

Regardless of the generally recognised enforcement difficulties related to behavioural remedies, it could be argued that in certain respects the small size of an economy could make the monitoring of compliance with behavioural remedies easier, as there are fewer market players and the number of cases is smaller, which makes deviations from the imposed remedies more readily detectable because of what might be termed the 'everybody knows everyone' phenomenon.[*56] At the same time, as noted above, in many cases the resources available to competition authorities in small economies are also more limited, which, in turn, poses problems for monitoring.

Hence, the effect of smallness on monitoring is varied and is greatly influenced by the specific circumstances of any given merger.

3. Conclusions

It should be recognised that, even though competition rules around the world tend to be driven largely by the same rationale and are therefore rather uniform as compared to many other areas of law (for instance, family law or inheritance law), one size does not necessarily fit all. Common-sense flexibility is required in merger control, because of the enforcement priorities influenced by the inherent values of the society concerned and the specific characteristics of the economy, be it small or large.

Smallness of an economy has a tendency to create high concentration and high entry barriers in many industries. However, in the context of open trade and globalisation, such effects of smallness are decreasing.

This article has analysed the implications of smallness for merger remedies, questioning whether the principles applicable to the use of merger remedies in large economies are equally appropriate in small economies. It can be concluded that small economies should indeed be guided by somewhat different principles than larger economies.

The large competition law regimes have strong preference for structural remedies, applying behavioural remedies only exceptionally. In small economies, greater flexibility is needed. This is because small economies may face difficulties in enforcing prohibitions or stringent structural remedies, stemming from their weak bargaining position *vis-à-vis* large international firms, particularly in cases of foreign-to-foreign mergers. Furthermore, structural remedies may not be available or would disproportionately reduce the efficiency gains or other public benefits related to the merger. In addition, even though enforcement of structural remedies

54 Annual Report on Competition Policy Developments in Austria 2003–2004, p. 14. Available at http://www.oecd.org/dataoecd/36/33/34720199.pdf (30.07.2008).

55 Annual Report on Competition Policy Developments in Austria 2005–2006. Available at http://www.bwb.gv.at/NR/rdonlyres/E459F1F0-439B-4B3C-8A8B-19C203B727C7/26202/Annualreport20052006final.pdf (30.07.2008).

56 OECD Background Paper (Note 1) paragraph 32.

is generally considered easier than enforcement of behavioural remedies, this may not always be true in the case of small economies.

In general, the effects of smallness in the context of merger remedies can take many forms. Also, of course, much depends on the specific circumstances of the merger under consideration and, more broadly, on the market conditions and other particularities of the economy in question.