Herbert Smith Freehills Competition Law Moot 2022

Problem Question

Prepared by Alison Jones and Andriani Kalintiri*

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RURITANIA IS A FICTIONAL MEMBER STATE OF THE EUROPEAN UNION

REFERENCE TO THE COURT OF JUSTICE OF THE EUROPEAN UNION UNDER ARTICLE 267 TFEU FROM THE RURITANIAN COURT OF APPEAL IN THE CASE OF:

Ruritanian Competition Authority v Puree Inc and Walnut Ltd

Introduction

1. The following paragraphs set out the factual and legal background to the questions referred to the Court of Justice of the European Union, as provided below, together with a summary of the parties' submissions to the Ruritanian Court of Appeal.

2. The case raises a number of issues relating to the interpretation of the EU Merger Regulation (Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings [2004] OJ L 24/1) (**EUMR**) and it is these issues that form the subject matter of the reference.

Background

Puree Inc and Walnut Ltd

3. Puree plc (**Puree**) and Walnut Inc (**Walnut**) are the parents of two independent groups of companies active on a global scale, including in the European Union (**EU**), in the production of baby food.

4. Puree has been active in the EU for more than 15 years. Walnut has been active in the US baby food market for many years and is an established brand there, but it only entered the EU market, including Ruritania, in 2017. Ruritania has been by far Walnut's most successful EU market to date

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and is also the location of most of its EU manufacturing facilities.

The baby food market in Ruritania

5. The baby food market in Ruritania is dominated by four main players, namely Nana Inc (**Nana**), Puree, Mash Ltd (**Mash**) and Walnut. Nana is the market leader with a 40% market share, while Puree, Mash and Walnut have a 25%, 15% and 10% market share respectively. The remaining 10% of the baby food market is dispersed among a number of fringe players, including supermarkets' own brand products and producers of specialty organic products, such as Delectably Bella.

6. Nana baby food products are manufactured at its Ruritanian plant which operates at 75% of its production capacity. Puree and Walnut also manufacture their products at their respective plants in Ruritania, which operate at 60% of their production capacity. Other fringe players have no or very little spare capacity.

7. Nana, Puree, Mash and Walnut make significant lump-sum payments to supermarkets to obtain shelf placement. For all players these payments represent a significant portion of their costs. Nana products are found in over 75% of all Ruritanian supermarkets, while Puree, Mash and Walnut products are sold in approximately 50% of all Ruritanian supermarkets. Most supermarkets only stock two of the four main brands, alongside their own brand (if any) and in some cases specialty, organic products.

8. Nana and Puree enjoy strong brand recognition in Ruritania and each carry more than 100 stock keeping units, that is, product varieties. Mash and Walnut carry about 80 stock-keeping units each. Nana, Puree and Walnut market themselves as value brands, while Mash markets its products as a premium brand.

9. Nana, Puree and Mash's market shares have not fluctuated significantly over the years. By contrast, although it only entered the Ruritanian market in 2017, Walnut has experienced constant growth by about 2% per year. The shelf price of Walnut's products is always slightly lower than those of its rivals and Walnut often offers consumers 4-for-3 discounts.

The Ruritanian merger control rules

10. The Ruritanian Merger Regulation (**RMR**) is based on the EUMR and its wording is identical to the wording of the EUMR, subject to minor variations required to reflect its national territorial scope and national system of enforcement, including different and lower jurisdictional turnover thresholds.

11. According to the RMR, all concentrations with a Ruritanian dimension must be notified to the

Ruritanian Competition Authority (**RCA**) for approval prior to their implementation. In approving or prohibiting a notified concentration, the RCA will examine whether or not the concentration would significantly impede effective competition in the Ruritanian market or in a substantial part of it. Article 25 of the RMR expressly provides that 'This Regulation is based on the provisions of Regulation 139/2004 and is to be interpreted consistently with it.'

12. The RCA has published guidelines for the assessment of horizontal and non-horizontal mergers, whose wording is identical to the wording of the equivalent horizontal and non-horizontal merger guidelines published by the European Commission.

The merger between Puree and Walnut

13. On 31 January 2021, Puree announced its intention to acquire the EU business of Walnut, which would carry with it all its EU trademarks and intellectual property associated with Walnut products. Walnut had been the subject of a takeover in the USA during 2020 and the new management had declared an intention to concentrate on the USA market with an aggressive growth plan over the next 10-12 years, and to sell off all overseas businesses, which it viewed as inherently unprofitable and not part of its core business. Having concluded that the merger did not meet the jurisdictional requirements of the EU Merger Regulation (it did not have an EU dimension), Puree notified the RCA seeking approval in accordance with the provisions of the RMR.

14. The parties argued before the RCA that the concentration would not significantly impede effective competition in Ruritania. First, it would allow the merged entity to compete more effectively with Nana, the market leader, and thus it would strengthen competition. Second, it would generate efficiencies by creating cost synergies, thanks to the integration and rationalization of their marketing, production and business processes in Ruritania, which would be passed on to consumers in the form of lower prices for the merged entity's baby food products.

The Ruritanian Competition Authority's Merger Decision

15. After the phase I investigation, the RCA concluded that the notified concentration raised serious doubts as to its compatibility with the Ruritanian market and on 28 February 2021 it adopted a decision to initiate a phase II investigation. On 15 March 2021, Puree and Walnut offered commitments to address the RCA's concerns, but, after their market testing, these commitments were ultimately deemed inadequate and were not accepted. Following the phase II investigation, on 30 April 2021, the RCA adopted a decision prohibiting the concentration in question under the RMR.

16. The RCA concluded that the concentration would lead to a significant impediment to effective competition in the Ruritanian market for the following reasons:

    a. On the balance of probabilities, the merger would give rise to non-coordinated effects in the Ruritanian market for baby food, insofar as Puree and Walnut are close competitors and Walnut is an important competitive force within the meaning of paragraphs 28 and 37 of the Ruritanian Horizontal Merger Guidelines. The concentration would thus lead to the removal of an important competitive constraint from the market. According to the gathered qualitative evidence, Puree and Walnut compete closely, both against one another and against the other baby food producers. Walnut has experienced constant and stronger growth than its rivals in recent years and it exerts significant competitive pressure on them through its pricing policy. According to the produced quantitative evidence, the concentration would lead to a predicted price increase of 6% post-merger. Given the cost of, and difficulty in, obtaining additional supermarket shelf space, the harmful non-coordinated effects of the concentration were unlikely to be offset by the non-merging parties' conduct or new entry.

    b. On the balance of probabilities, the concentration would lead to coordinated effects. Post-merger there would remain only three main players in the Ruritanian market for baby food, which would be able to coordinate their behaviour to raise prices. The demand and supply conditions are relatively stable, while post-merger Nana and Puree/Walnut in particular would be rather symmetric in terms of their market shares and cost structures. Moreover, Nana, Puree/Walnut and Mash can easily monitor each other's prices and engage in short-term price wars if any deviation from the terms of their coordination is detected. New entry is unlikely, and the reactions of consumers and other fringe players will not be sufficient to jeopardize the success of the coordination.

    c. The merging parties failed to demonstrate that the concentration would lead to efficiencies that are merger-specific and would outweigh the above non-coordinated or coordinated effects.

The Appeal before the Ruritanian High Court

17. On 1 June 2021, the parties brought an action for annulment of the RCA's decision prohibiting the concentration before the Ruritanian High Court.

18. After hearing the case, on 1 October 2021, the Ruritanian High Court annulled the decision of the RCA to prohibit the concentration between Puree and Walnut on the following grounds:

    a. RCA had applied the wrong standard of proof. Given the severe consequences flowing from a prohibition decision for the merging parties and the forward-looking nature of merger review,

the RCA had to prove that there was a strong probability that the merger would lead to a significant impediment to effective competition. This standard of proof is higher than the balance of probabilities, but is not as onerous as the 'beyond any reasonable doubt' standard that applies in criminal enforcement.

b. The RCA misapplied the significant impediment to effective competition test.

   i. The RMR does not contain a presumption of incompatibility for mergers in oligopolistic markets.

   ii. In the case of concentrations in oligopolistic markets, which do not lead to the creation or strengthening of an individual or collective dominant position, demonstrating non-coordinated effects requires showing that the concentration confers on the merged entity the power to determine, by itself, the parameters of competition and, in particular, to become a price maker instead of remaining a price taker. In particular, two cumulative conditions must be established: (a) the elimination of important competitive constraints that the merging parties had exerted upon each other; and (b) a reduction of competitive pressure on the remaining competitors.

   iii. The RCA failed to apply this test and demonstrate both conditions. Further, the RCA had not demonstrated that Puree and Walnut were particularly close competitors. The mere fact that Walnut had experienced constant and stronger growth than its rivals in recent years, and its prices are slightly lower than theirs, does not suffice to show that it stands out from its competitors in terms of its impact on competition.

c. The RCA failed to demonstrate why the predicted price increase of 6% was significant and merited the prohibition of the concentration, especially given that the RCA had in the past cleared, subject to certain conditions, concentrations which had been predicted to lead to higher price increases.

d. The RCA failed to establish the predicted price increase of 6% with a sufficient high degree of probability, insofar as its quantitative analysis did not take into account all the relevant factors which may affect the price level. In particular, the quantitative analysis did not take into account the 'standard efficiencies' that all mergers lead to as a result of the rationalization and integration of production and distribution processes by the merged entity, which may lead it to lower its prices. The RCA erred in not including these standard efficiencies in its quantitative analysis on the basis that it was for the notifying party to demonstrate their existence.

e. The RCA failed to demonstrate that the concentration would lead to a significant impediment of effective competition by means of coordinated effects. In any event, the decision of the RCA

suffers from inadequate reasoning, insofar as it is irrational to rely on theories of both non-coordinated and coordinated effects where these are inconsistent with each other.

The Current Proceedings before the Ruritanian Court of Appeal

19. According to Ruritanian law, the judgments of the Ruritanian High Court can be appealed before the Ruritanian Court of Appeal on points of law only.

20. On 1 November 2021, the RCA brought an appeal against the judgment of the Ruritanian High Court before the Ruritanian Court of Appeal arguing that the Ruritanian High Court erred in law by:

    a. Applying an incorrect standard of proof for merger decisions, that is, one higher than the balance of probabilities. Given the absence of criminal charges and the prospective nature of merger review, a 'strong probability' standard of proof is unwarranted and would undermine the RCA's ability effectively to enforce the RMR, one of the rules designed to ensure that competition in Ruritania is not distorted.

    b. Holding that, in order to establish a significant impediment to effective competition in an oligopolistic market, it is necessary, in the absence of a dominant position being created or strengthened, to demonstrate:

        i. That the concentration would confer on the merged entity the power to determine, by itself, the parameters of competition and, in particular, to become a price maker instead of remaining a price taker; and

        ii. A reduction of competitive pressure on the remaining competitors as well as the elimination of important competitive constraints that the merging parties had exerted upon each other.

    c. Adopting an unduly narrow interpretation of the concepts of close competitors and important competitive force, which is out of tune with economic theory, despite the aim of the RMR to ensure that competition in Ruritania is not distorted.

    d. Requiring the RCA to demonstrate that the predicted price increase of 6% was 'significant' and by holding that the quantitative analysis of the RCA should have taken into account the 'standard efficiencies' that all mergers give rise to. Neither the RMR, nor economic theory, nor experience can be relied on to presume that all mergers create efficiencies for the purposes of such quantitative analysis. Moreover, the RCA only bears the legal burden of demonstrating anticompetitive effects, while the legal burden of proving the existence of efficiencies rests with the merging parties.

e. Holding that the decision of the RCA suffered from lack of adequate reasoning, insofar as the RCA had relied on two inconsistent theories of harm. It is sufficient that at least one theory of harm has been adequately established for a significant impediment to effective competition to be established.

21. The merging parties disputed the RCA's claims that the Ruritanian High Court erred in law arguing, among others, that:

a. The standard of proof that applies to merger decisions is 'strong probability', rather than the balance of probabilities and rightly so, given the implications of a prohibition decision for the merging parties' fundamental rights, the ex-ante nature of merger control and the RCA's extensive investigative and decision-making powers, which resemble its powers in the context of antitrust enforcement, where a stricter standard of proof than the balance of probabilities applies.

b. The RCA must demonstrate that a concentration would significantly impede effective competition in the Ruritanian market in order to prohibit it, taking account of both its anticompetitive effects and any efficiencies that may offset these.

i. In the case of concentrations in oligopolistic markets that do not lead to the creation or strengthening of a dominant position, it is not sufficient to demonstrate that the concentration would lead to a reduction in competitive pressure due to the removal of a close competitor or important competitive force in order to establish a significant impediment to effective competition. If this interpretation of the test were accepted, then the RCA would be able to prohibit all horizontal concentrations in oligopolistic markets since, by default, they lead to a reduction in the competitive pressure due to the decrease in the number of players remaining in the market.

ii. The wording of the significant impediment to effective competition test requires that any anticompetitive effects be 'significant'. There is nothing in the RMR to suggest that the significance of the anticompetitive effects of a concentration can be presumed.

iii. The RCA's legal burden consists in demonstrating that the concentration will not lead to anticompetitive effects that will not be offset by any efficiencies. Thus, in establishing the anticompetitive effects of a concentration, the RCA cannot ignore the standard efficiencies that all mergers give rise to as a result of the integration and rationalization of the merging parties' activities and processes. This also applies to any quantitative analysis that the RCA carries out.

Questions Referred

22. Faced with such fundamental differences in interpretations and readings of the law, the Ruritanian Court of Appeal has decided to stay the proceedings before it and refer a number of questions relating to the interpretation of the EUMR to the Court of Justice of the European Union in order to ensure that their decision will be consistent with the EUMR, as required by the RMR.

23. The merging parties have challenged the decision of the Ruritanian Court of Appeal to make the reference on the basis that, pursuant to Article 267 TFEU, the Court of Justice only has jurisdiction to give preliminary rulings concerning the interpretation of the Treaties and the validity and interpretation of acts of the institutions, bodies, offices, or agencies of the Union, but, in this case, it is being asked to interpret Ruritanian law.

24. In this light, the Ruritanian Court of Appeal has referred the following questions to the Court of Justice:

Question 1: Does the Court of Justice have jurisdiction to hear and determine the request for a preliminary ruling, since EU law is not applicable in the dispute in the main proceedings? If yes, is its jurisdiction limited to questions of substantive law, such as the interpretation of the 'significant impediment to effective competition' test for the assessment of notified concentrations, or does it extend to questions of procedural law, such as the standard of proof to which merger decisions are subject?

Question 2: Assuming that the Court of Justice has jurisdiction to hear the case with respect to both substantive and procedural questions, is the balance of probabilities the standard of proof to which merger decisions under the EUMR are subject, meaning that a merger should be prohibited where, based on the evidence, it is more likely than not that it would lead to a significant impediment to effective competition and it should be allowed where, based on the evidence, it is more likely than not that it would not lead to a significant impediment to effective competition? If not, what is the standard of proof to which merger prohibition or clearance decisions under the EUMR are subject?

Question 3: In circumstances such as those in the main proceedings, what are the conditions that must be satisfied for establishing the existence of non-coordinated effects and thus of a significant impediment to effective competition in the meaning of Article 2(3) of the EUMR? In particular should Article 2(3) of the EUMR be interpreted as requiring that:

a. The concentration confers on the merged entity the power to determine by itself the parameters of competition and, in particular, to become a price maker instead of remaining a price taker?

b. Two cumulative conditions must be established: (i) the elimination of important competitive constraints that the merging parties had exerted upon each other; and (ii) a reduction of competitive pressure on the remaining competitors?

c. The merging parties must be established to be particularly close competitors?

d. The merger results in the elimination of an important competitive force which stands out from its competitors?

Question 4: Should Article 2(3) of the EUMR be interpreted as meaning that, in order to prohibit a concentration, it is necessary to show not only that the concentration will have a negative impact on competition, but also that this impact will be 'significant'?

Question 5: Should the EUMR be interpreted as entailing a presumption that all mergers generate 'standard efficiencies' stemming from the integration and rationalization of the merging parties' activities and processes that the competition authority must take into account when demonstrating the existence of a significant impediment to effective competition?

Question 6: Where a finding of a significant impediment to effective competition has been demonstrated on the basis of theories of both non-coordinated and coordinated effects, is it necessary that the two theories are not contradictory (are consistent with each other), or does it suffice that at least one of them has been adequately established?

25. The request for a preliminary ruling arrived at the Court of Justice on 7 December 2021. In accordance with Article 23 of the Statute of the Court of Justice, the Registrar has notified the claimant and defendant and has invited them to submit written observations to the Court. The deadline for submission is on 8 April 2022. Oral hearings are provisionally scheduled for 17-18 June 2022.

Note: Article 267 TFEU provides a procedure where a national court may request the Court of Justice to give a preliminary ruling on a question on the interpretation of EU law, where a decision on the question is necessary to enable the national court to give judgment. The Court of Justice does not therefore deal with questions of fact. Rather, it is for the national court to apply the interpretation of EU law to the facts of the case in front of it.