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Agenda Item 3b. Challenges faced by young and small competition agencies in the design of merger control

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Challenges in the design of a merger control regime for young and small competition authorities

Italian Competition Authority

Introduction

An effective merger control regime stems from a combination of several factors, which include *inter alia* a clear and adequate definition of mergers, quick and transparent review procedures and consistent notification thresholds. This contribution focuses on notification thresholds because they are a key factor for capturing the most significant concentrations that have a material nexus to the reviewing jurisdiction. At the same time, the establishment of adequate thresholds determines the number of operations to be notified and the resources to be used. As highlighted in the Note by the UNCTAD Secretariat, this may be of particular importance for young and small agencies, insofar as it may strongly affect their efficiency and the quality of their control.

1. The experience of the Italian Competition Authority

The notification thresholds of the Italian merger review regime are based on turnover or sales, as they provide an objective measure of the potential impact of a transaction on the market and this information is readily available to companies. In addition, notification thresholds are based on the domestic turnover as the latter can be a good predictor of whether a sufficient local nexus exists[1].

Following a reform adopted in 2012, a transaction is subject to ex-ante notification if:

a) the combined aggregate nation-wide turnover in Italy of all undertakings concerned was higher than 495€m (2015 value);
b) and the aggregate nation-wide turnover in Italy of the acquired business was higher than 50€m (2015 value).

Notification thresholds relate to the parties' turnover in the previous financial year, i.e., the amount derived from the sale of products or the provision of services (excluding turnover taxes)[2]. Notification thresholds are updated by the Italian Competition Authority (AGCM) on a yearly basis to reflect the increase in the

[1] Notification provisions are in Section 16 of the Italian Competition Law (Law No. 287 of October 10, 1990). Implementing regulations are in Section 5, Presidential Decree No. 217 of April 30, 1998. Guidance regarding notifications (when to notify, how to calculate thresholds etc.) is provided in the Guidance to Notification Form.

[2] Relevant turnover figures are calculated in a manner consistent with the principles set forth in the European Commission's Consolidated Jurisdictional Notice. In particular, aggregate nation-wide turnover means the turnover from the sale of products and services during the previous financial year on the Italian market after deducting returned products and discounts, as well as taxes directly relating to the sale of products and the provision of services. Sales are allocated geographically by reference to the location of customers at the time the products were sold or the services were provided. Although there are no sector-specific thresholds, the Competition Law provides for special rules for the method of calculation of banks and insurance companies' turnover, as well as particular rules in the cinema sector.

gross domestic product (GDP) deflator index. The resolution is published on the Authority's website after the increase in the index has been officially announced.

1.1 The 2012 Reform to the merger notification system

Before the 2012 Reform, a transaction was required to be notified even if only one of the two turnover thresholds was met (alternative thresholds).

In the Authority's experience, the old test based on the two alternative thresholds resulted in an elevated number of notified transactions, most of which with no significant competition effects. In fact a very limited percentage (below 2%) of the notified mergers required an in depth investigation. Moreover, the alternative test captured international transactions having no material impact on the Italian territory. To partially remedy this issue, the Authority had introduced in its practice an exemption for foreign-to-foreign transactions[3].

The reform of the Italian notification system introduced in 2012 rendered the two thresholds cumulative rather than alternative, i.e., transactions were required to be notified only if both turnover thresholds were met. As a result, the filing obligation was eliminated in a significant number of cases where turnover of the acquiring group in Italy was in excess of the first threshold, but the target itself only achieved limited sales in Italy. This was the case, for example, with regard to small local purchases part of a larger international acquisition, the acquisition of negligible business branches (e.g., an outlet) by a large retailer, or the mere transfer of regulatory licenses or patent portfolios of limited value.

The rationale behind the less stringent notification criteria set out by the 2012 reform was to align the Italian merger regime to the recommendations of international organisations like OECD and ICN, reduce unnecessary costs and burden for businesses and release AGCM from dealing with smaller concentrations thus enabling it to focus on more serious antitrust infringements.

1.2 The monitoring of the 2012 Reform

The shift from an alternative to a cumulative test occurred without any modification of the turnover thresholds and this has raised the question as to whether the current levels of turnover thresholds were still adequate in the new scenario, that is, whether the new jurisdictional test could have excluded some potentially problematic transactions from merger review for failing to meet the second threshold. This could be an issue in certain sectors, e.g., commercial distribution, where relevant competitive effects could arise from subsequent operations below thresholds.

Mindful of this issue, the Authority began a monitoring exercise and carried out a retrospective analysis of the effects of the 2012 test over the period 2000-2012. The analysis has showed the risk of excluding some potentially problematic transactions from merger review. In particular, the AGCM found that two thirds of the notifications filed under the pre-2012 reform system would have been excluded under the current system

[3] For example, the acquisition of sole control over foreign companies, which at the time of the acquisition and in the three preceding years, did not have any turnover on the Italian market, was exempted from notification requirement unless it was expected that the acquired business would produce a turnover in Italy as a consequence of or in connection with the transaction. Similarly, joint ventures - in which one of the concerned companies is a foreign entity – were exempted from notifications if the foreign entity had no turnover on the Italian market at the time of the acquisition and in the three preceding years, except where as a consequence of or in connection with the transaction the joint venture will produce a turnover in Italy.

for failure to meet the target threshold. Moreover, 13 over 45 (30%) Phase 2 concentrations reviewed in the period 2000-2012 would have escaped the notification obligation with the 2012 reform.

In other words, the change in the notification threshold test highlighted that transactions once filed under the old disjunctive test - because they met the first threshold only - could include some potentially problematic concentrations which, under a conjunctive test, would escape the review because of a target threshold set "too high".

1.3 The public consultation and new legislative developments

The AGCM decided to share with the public its preliminary analysis of the effects of the new regime and launched a public consultation in 2014 with a view to possibly recommending to Parliament the amending of the thresholds of the merger control regime. The public consultation procedure was aimed to increase transparency and provide stakeholders the opportunity to contribute to the debate.

As a proposal for consultation, the AGCM suggested amending the jurisdictional test as follows:

- decreasing the second threshold concerning the target's Italian turnover from €49 million (the 2012 value) to €10 million; and
- clarifying that, for a deal to be reviewed by the Authority, this second threshold shall be met by at least two of the undertakings concerned, leaving unchanged the first threshold[4].

Several stakeholders took part in the consultation, including law firms and business associations. Law firms were supportive of the AGCM proposals, which in their view would align the Italian merger control framework to the international best practices. From the business perspective, the proposals put forward by the Authority would represent a substantial change of the merger review regime, shortly after the 2012 reform, which could have undermine legal certainty and business confidence. Furthermore, the business community considered that a lower target threshold would not encourage the consolidation of many fragmented industries and sectors in Italy, through M&A operations seeking efficiencies and scale economies.

Taking into account the contributions received, the AGCM concluded that more time was needed to accurately assess the longer-term effects of the revised notification test and decided to continue the monitoring of the 2012 reform.

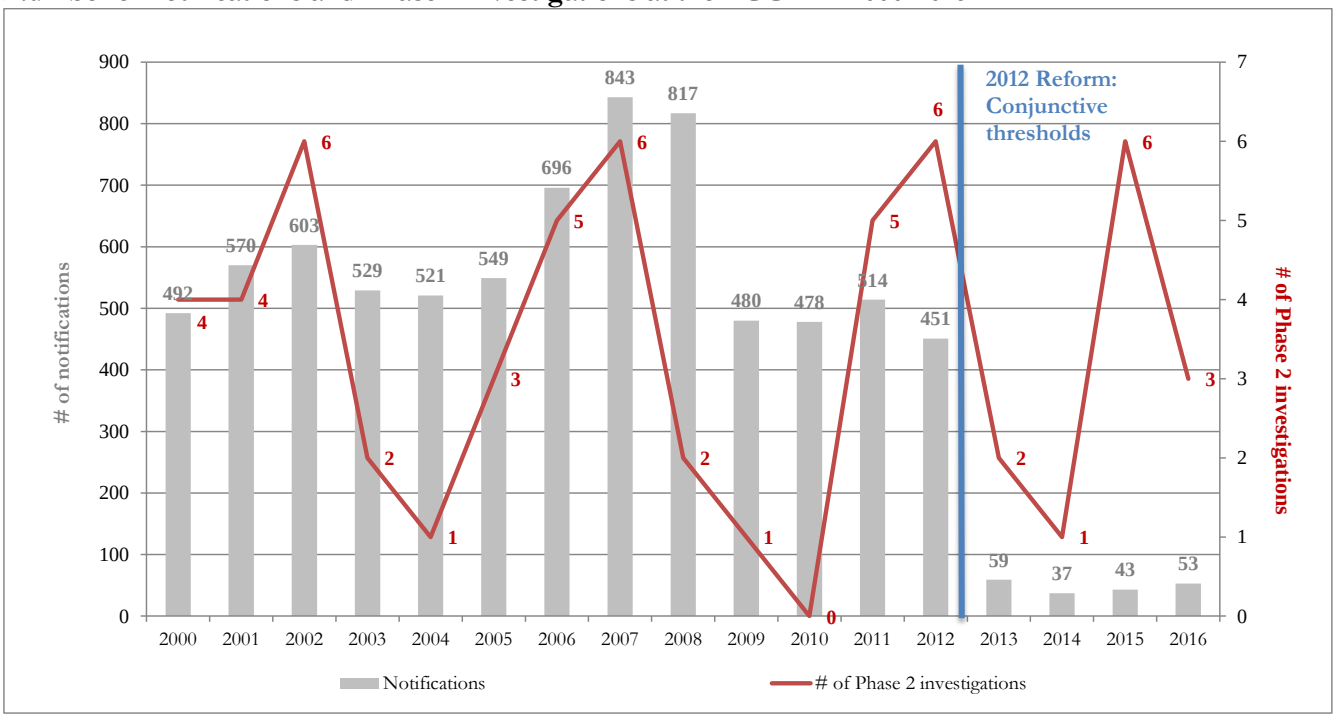
As of June 2017, a draft competition bill is currently being discussed by the Italian Parliament: besides the introduction of measures to open up competition in several sectors (such as insurance, banks, post offices and pharmacies), the bill envisages a provision amending the current notification system in the direction advocated by the Authority, that is, by lowering the second threshold to €30 million and making it applicable to at least two of the undertaking concerned. The bill will become law if the Parliament's second chamber passes it without further amendments.

1.4 Recent trends in the number of notifications

[4] This wider formulation of the second threshold, which removes the reference to the target company and extends the threshold to at least two of the parties to the transaction, is mainly intended to improve the notification system for transactions other than acquisitions (i.e., mergers and creation of joint ventures) and strengthened the local nexus.

As expected, the drop in the merger notifications experienced in 2013 has been confirmed over the following two years, while the trend in the number of Phase 2 investigations has remained unchanged.

Number of notifications and Phase 2 investigations at the AGCM in 2000-2016



Source: AGCM

2. The ICN Recommended Practices for Merger Notification and Review Procedures

The Recommended Practices for Merger Notification and Review Procedures published by the International Competition Network[5], which have been revised in 2017, provide a set of valuable indications concerning merger thresholds and nexus to the reviewing jurisdiction. The ICN Recommended Practices are designed to make merger review more efficient and effective and minimize unnecessary burden on reviewing agencies and merging parties alike. Despite being non-binding aspirational statements, the ICN Recommended Practices have become an international benchmark for sound merger review policy, due to the members' willingness to adopt practices at odds with many of their own merger review procedures, together with a legitimacy gained from close partnership between competition agencies and private bar in drafting the recommendations.

The ICN Recommended Practices emphasise that jurisdiction should be asserted only over transactions that have a material nexus to the reviewing jurisdiction, that is, when a proposed transaction has a significant and direct economic connection to the jurisdiction. The most common means of providing for a material nexus is by requiring significant local sales or local asset levels in the merger notification thresholds. This criterion may be satisfied if each of at least two parties to the transaction have significant local activities; alternatively, it may be satisfied if the acquired business has a significant presence in the local territory, such as significant local assets or sales in or into the reviewing jurisdiction.

[5] Available at: http://www.internationalcompetitionnetwork.org/uploads/library/doc1108.pdf

Furthermore, the ICN Recommended include several considerations intended to ensure that mandatory notification thresholds are based on objectively quantifiable criteria, as well on information that is readily accessible to the parties to the proposed transaction.

3. Conclusions

The Italian Competition Authority's experience confirms that it is not easy to achieve the optimal mix between effectiveness of a merger review system and avoidance of unnecessary burdens and costs on merging parties.

The revised notification test introduced in Italy by the 2012 Reform has significantly reduced the number of notifications of non-problematic transactions reviewed by the Authority. However, the experience with the new system so far has shown that an adjustment in the level of thresholds is desirable in order to minimize the risks that some potentially problematic transactions may escape the merger review.

The international experience developed in international fora such as ICN can represent a precious source of inspiration for young and small competition authorities with a view to adopting an appropriate notification system.