FRONTIERS OF LAW IN CHINA
VOL. 8 JUNE 2013 NO. 2
DOI 10.3868/s050-002-013-0012-0

ARTICLE

CONGLOMERATE MERGER CONTROL: FROM THE CONTINENTS TO A SMALL ECONOMY

Jessie Xinyu Wang,[*] *Y. Stephen Chiu*[**]

To condemn a conglomerate merger for the foreclosure effect of post-merger activities, one should examine the anticipated conduct against the same liability rules under the law of agreement and the law of abuse of dominance as if the conduct has been materialized. Given the inherent uncertainty of pre-merger assessment, it requires a high standard of proof to satisfy the adjudicator that the merger in question would lead to anticompetitive effect in all the circumstances. Conglomerate merger, which will reinforce market concentration or increase entry barriers, should be stringently scrutinized. Saying so, the pro-efficiency effects of conglomerate merger are appreciated. One should not take it for granted that agglomeration will be restrained through conglomerate merger control.

INTRODUCTION ····· 305
I. LAW OF CONGLOMERATE MERGER CONTROL ····· 307
A. Merger Control Policy ····· 307
B. Overview of the US and the EU Attitudes towards Conglomerate Merger ····· 308
1. The US Position ····· 308

[*] Bachelor, practising law at Angela Ho & Associates, at Faculty of Law, University of Hong Kong, Hong Kong, China. Contact: jessieibm@gmail.com

[**] Ph.D and Associate Professor, at Faculty of Business and Economics, University of Hong Kong, Hong Kong, China. Contact: stephen.chiu@hku.hk

This paper is developed from a research project that the first author conducted in her final year of studies at the University of Hong Kong. She would like to give special thanks to Professor Mark Furse for enlightening her on conglomerate merger, to Professor Fu Hualing for monitoring the oral defense, and to Associate Professor Cheng Kin Hon Thomas for supervising the final project and guiding along studying competition law.

2. The EU Position ····· 310
3. Reasons for the Divergence ····· 311
4. GE/Honeywell: A Landmark Disapproval ····· 313
II. A CLOSER LOOK AT THE EU NON-HORIZONTAL MERGER GUIDELINES ····· 316
A. Assessing Unilateral Effects: "3-Step" Test ····· 316
B. The Harm Theories: Market Power Leveraging and Foreclosure ····· 317
1. Commercial and Technical Tying ····· 317
2. Fixed and Mixed Bundling ····· 317
C. Likelihood of Foreclosure: Economic Considerations ····· 320
1. Ability to Foreclosure ····· 320
2. Incentive to Foreclosure ····· 321
3. Likelihood to Foreclosure ····· 321
4. Market Concentration ····· 324
5. Trade-Off Balance between Anticompetitive Effects and Efficiencies ····· 326
6. The Commission Has a High Standard of Proof ····· 327
III. DEVELOPING A CONGLOMERATE MERGER CONTROL REGIME IN HONG KONG ····· 328
A. Market Concentration and Removal of Competitors ····· 329
B. Entry Barriers ····· 331
C. Efficiency Considerations ····· 333
CONCLUSION ····· 334

INTRODUCTION

Agglomeration of firms running global business has become a phenomenon of this age. Hong Kong is no exception, rather dominates the FinanceAsia100 conglomerate with all four constituents hailing from this territory.[1] These firms were able to generate respectable revenues at economic downturns.[2] This is attributable to their involvement in property development, which is so

[1] *The FinanceAsia100 Sector Reports* (2008–2009), at http://www.fa100index.com/sector_conglomerates.htm (last visited Oct. 16, 2012). The four conglomerate firms referred to Hutchison Whampoa, Swire Pacific, Jardine Matheson and Jardine Strategic.

[2] Id.

profitable that there has been public indignation against the developers for their abusive pricing.[3]

Adopted on 14 June 2012, the new Competition Ordinance of Hong Kong does not have a cross-sector merger control regime.[4] Schedule 7 of the Ordinance applies in a merger where one or more merging parties are telecommunications "carrier licensee," defined as including local and external fixed network operators and mobile network ones under the old regime, still valid.[5] Schedule 7 does not specifically provide for conglomerate merger. A broad interpretation is that as long as a carrier license acquires or is acquired by another business, whether or not a telecom firm, the merger control rules would apply. The specific scope of its application will depend on whether the Competition Commission would make the competition analysis to this far. Under the modernized regime, the Competition Commission has the sole jurisdiction, unless legal proceedings will be involved, over the determination of whether a merger has, or is likely to have, the effects of substantially lessening competition in Hong Kong.[6] The Competition Commission is responsible to issue guidelines on merger notification and the determination process, subject to consultation and amendments.[7]

Even though the government considers it too early to introduce a broader regime, conglomerate merger issues are inevitable for the competition jurisdiction of Hong Kong, given the extensive reach of conglomerate firms in the economy. This paper will start with an overview comparison of the conglomerate merger control regimes of the US and the EU, then elaborate

---

[3] See Alice Poon, *Land and the Ruling Class in Hong Kong*, Enrich Professional Publishing (2nd edition) (Hong Kong), 2009.

[4] *Schedule 7 of the Competition Ordinance*, Ordinance No. 14 of 2012.

[5] Article 2 of the Telecommunications Ordinance, Chapter 106 of the Laws of Hong Kong Special Administrative Region. The old regime set out under Section 7P of the Telecommunications Ordinance was repealed by the Competition Ordinance with no prejudice to relevant interpretation sections. For reference, see also *Telecommunications Authority Guidelines: Mergers and Acquisitions in Hong Kong Telecommunications Markets*, CB(1)2416/10-11(02), at http://www.legco.gov.hk/yr09-10/english/bc/bc12/papers/bc120607cb1-2416-2-e.pdf (last visited Nov. 11, 2012).

[6] *Schedule* 7 *of the Competition Ordinance*, art. 11.

[7] Id. art. 17.

on each economic consideration in more details against the analytical framework set out in the European Union Non-horizontal Merger Guidelines (hereinafter, the "EU Guidelines") and lastly, with focus on the small market economy status of Hong Kong, propose for a conglomerate merger control framework that is suitable for Hong Kong.

I. LAW OF CONGLOMERATE MERGER CONTROL

A. Merger Control Policy

Merger control in most jurisdictions deal with the same two types of anticompetitive conducts as addressed in the conduct rules that are likely to result from a merger that the merged firm will enhance its market power or become dominant in the market or that firms remaining in the market are likely to collude after the merger. Merger control operates prospectively with the attempt to predict the likelihood and prevent anticompetitive outcomes of an event. For years, the US merger review paid much closer attention to coordinated interaction than to unilateral effects. The EU merger control has traditionally focused on preventing the creation or strengthening of a dominant position.[8] It was only when the European Union Merger Regulation (then, the European Community Merger Regulation) was revised in 2004 that the substantive test became "significant impediment of effective competition."[9] In practice, the change in market structure is an important indicator of potential anticompetitive effect. For example, in GE/Honeywell, General Electric (GE) was considered to become a dominant firm in the markets for large commercial and regional jet aircraft engines and cause their rivals to withdraw from the relevant markets because of the inability to compete.[10] Based on these findings, the merger was held to have significant impediment to effective competition and therefore prohibited. The merger had been earlier approved by the US DOJ. The case raised a hot debate across the Atlantic as to whether antitrust authorities should intervene in this type of merger, namely conglomerate merger, on an *ex ante* basis.

---

[8] Thomas K. Cheng, *Convergence and Its Discontents: A Reconsideration of the Merits of Convergence of Global Competition Law*, 12(2) Chi. J. Int'l L. 467 (2012).

[9] Council Regulation 139/2004, 2004 OJ (L 24) 7.

[10] Case No. COMP/M.2220.

B. Overview of the US and the EU Attitudes towards Conglomerate Merger

Conglomerate merger refers to the merger between firms that have no existing or potential competitive relationship either as competitors or suppliers and customers.[11] There is no immediate change in the market structure resulted from a merger. Even though there has been a consensus of two jurisdictions that conglomerate merger rarely poses competition problems, it is left open to be challenged in the EU on the two grounds, one being foreclosure effects and the other being coordination effects.[12] The EU Guidelines further set out a 3-step approach for assessing foreclosure effects. In contrast, the US 1984 and 1982 Merger Guidelines do not contain any conglomerate merger theories. The federal antitrust law enforcement agencies have not challenged a merger on a conglomerate theory since 1966.[13]

1. The US Position. — The United States experienced a wave of conglomerate merger from the 1950s to 1975.[14] During that period, the Department of Justice ("DOJ") and the Federal Trade Commission ("FTC") developed a

---

[11] *The EU Non-Horizontal Merger Guidelines* defines **c**onglomerate merger as mergers between firms which have no existing or potential competitive relationship either as competitors or as supplier and customer and therefore do not give rise to either horizontal or vertical issues. One may say that it is a merger that is neither horizontal nor vertical. It may involve complementary products and unrelated products. In the latter case, competition issues are unlikely to arise. The US Supreme Court has made a distinction between "pure conglomerate merger" and mergers which are "neither horizontal, vertical nor conglomerate." For pure conglomerate merger, there is no economic relationship between the merging firms. Within the latter classification are mergers of firms selling complementary products or the same product but in different geographic markets. This shows that in both jurisdictions conglomerate merger is broadly defined as all mergers which are neither horizontal nor vertical.

[12] *The EU Non-horizontal Merger Guidelines* ("EU Guidelines"), ¶92–121.

[13] J. Thomas Rosch, *Terra Incognita: Vertical and Conglomerate Merger and Interlocking Directorate Law Enforcement in the United States*, speech at the University of Hong Kong, Sept. 11, 2009.

[14] See Frederic M. Scherer & David Ross, *Industrial Market Structure and Economic Performance* (3rd edition), Houghton Mifflin (Boston), at 90–94 (1990). Scherer and Ross note that "[t]he year 1975 has proved to be a high-water mark in U.S. corporations' diversification, for many of the diversification-increasing mergers were unsuccessful. A back-to-basics movement followed in the 1970s and early 1980s, entailing the divestiture of thousands of subsidiaries, most of which joined the parent through previous diversifying mergers."

number of theories to challenge the mergers.[15] Two of the novel theories of conglomerate harm were endorsed by the Supreme Court: reciprocity[16] and entrenchment.[17] Reciprocity occurs when the merged firm conditions its purchase of product A from its supplier on the supplier's purchase of product B from the firm. Entrenchment occurs when a dominant firm in a concentrated market is acquired by a firm of larger size and strength. The merged entity becomes more efficient than its rivals because of economies of scale and has deeper pockets to engage in predation in the market of the acquired firm.[18] According to Church, these theories reflected the view to protect the competitive process. However, the best way to achieve this would be to maintain a low degree of concentration and a multiplicity of competitors in the market.[19] Had the court allowed an efficiency defense, the cases would be decided differently.

Subsequent antitrust enforcement has been heavily influenced by the Chicago School economics.[20] As a result, enforcement agencies recognized the central importance of consumer welfare and efficiency that could be immediately resulted from conglomerate merger. The FTC decision affirmed that predatory effects could not be assumed. Rather, it should be proved to be reasonably likely and significant. Where the evidence of probable adverse anticompetitive effect is unclear, a conglomerate merger should not be condemned on its efficiencies.[21] The entrenchment theory and the reciprocity

---

[15] It has been advocated that conglomerate mergers could entrench market power in the acquired firm's markets, encourage cross-sector subsidization, increase "deep-pocket" advantage, increase entry barriers, result in increased, non-economic reciprocity arrangement, and increase macro-concentration and the size of power groups. For detail discussion of the theories, see J. Fred Weston, *The Nature and Significance of Conglomerate Firms*, 44 St. John's L. Rev. 66 (1969–1970). It was observed that in the absence of empirical analysis on the materialization of the concerns, the antitrust authority was not proactive to intercept proposed mergers given the cognizable economic benefits in the mergers.

[16] *FTC v. Consolidated Foods Corp*., 380 U.S. 592 (1965).

[17] *FTC v. Procter & Gamble Co*., 386 U.S. 568 (1967).

[18] Jeffrey Church, *Conglomerate Mergers*, in *2 Issues in Competition Law and Policy*, *ABA Section of Antitrust Law*, American Bar Association (Chicago, III), at 1508–11 (2008).

[19] Id. at 1508.

[20] See Rosch, fn. 13.

[21] Heublein Inc., 96 F.T.C. 385 (1980). For a recent submission, see *Antitrust Division Submission for OECD Roundtable on Portfolio Effects in Conglomerate Mergers (2001)* (hereinafter, the "Antitrust Division Submission"), at http://www.usdoj.gov/atr/public/international/9550.pdf (last visited Oct. 16, 2012).

theory were respectively eliminated from the US Merger Guidelines in 1982 and 1984. As seen in the GE/Honeywell debate, the current US position does not deviate from the 1980s' Guidelines. Instead of prohibiting a merger for rather remote range effects, *ex post* prosecution would be preferred when the merged firm has allegedly entered into anticompetitive agreements or abused their market power after a merger.

2. The EU Position. — Even though the entrenchment theory has almost faded away in the US, it has arguably inspired the counterparty of EU to develop an assessment framework proactively intercepting problematic conglomerate mergers.[22] The EU Guidelines expressly provide that conglomerate merger may raise concerns when leveraging of market power is possible. Notably when the merging firms sell complementary products or range products that can be sold to the same set of customers, the merged firm is likely to foreclose competitors, maintain or enhance its power through tying, bundling or other exclusionary conducts.[23] The Guidelines focus on whether the circumstances give the merged entity the incentive and ability to engage in these activities. The test for foreclosure effect is exit or marginalization of competitors, in other words, whether a significant large fraction of the market will be affected.[24]

The EU takes the view that exit or marginalization of competitors is irreparable and prices would eventually rise to harm consumers.[25] For example, if competitors have been driven out of the market and entry barriers have been subsequently increased, it is hardly conceivable that *ex post* punishment can do anything to restore competition. Therefore, a wait-and-see strategy would be too costly in such circumstances.[26] Further, it should not

---

[22] William J. Kolasky, *Conglomerate Mergers and Range Effects: It's a Long Way from Chicago to Brussels*, 10 Geo. Mason L. Rev. 533 (2001), at http://www.justice.gov/atr/public/speeches/9536.htm (last visited Nov. 11, 2012).

[23] The foreclosure effect is set out under the EU Guidelines, ¶92. In practice, the possibility of leveraging a strong market position from one market to another will be examined for all relevant markets. E.g., GE/Honeywell merge might lead to leverage.

[24] See the EU Guidelines, ¶93. Bishop distinguishes marginalization of competitors with causing competitors to lose market share or reduce output, which does not necessarily amount to a significant impediment to competition.

[25] Dimitry Giotakos, *GE/Honeywell: A Theoretic Bundle Assessing Conglomerate Mergers across the Atlantic*, 23 U. Pa. J. Int'l Econ. L. 469, 505 (2002).

[26] Id.

be taken for granted that the enforcement agency will be effective and efficient in regulating firm behavior *ex post*.[27] Indeed, relying on *ex post* prosecution to address potential range effects would increase the burden of the enforcement agency, compared with exercising stringent scrutiny beforehand to prevent likely illegalities from happening.

Apart from assessing unilateral effects, the 2007 Non-horizontal Merger Control Guidelines also draw a vague picture of post-merger coordination effects.[28] The Guidelines state that coordination is more likely to emerge where it is fairly easy to identify the terms of coordination and where such coordination is sustainable. Where the number of effective competitors is reduced to an extent, tacit coordination becomes a real possibility. Therefore, mergers that create oligopoly and duopoly markets are more likely to present coordination effects. This has significant implications on small market economies such as Hong Kong, where the market size decides it can only hold a small number of competitors.[29]

3. Reasons for the Divergence. — What accounts for the difference in the attitude about conglomerate merger enforcement between the US and the EU? Firstly, the economic approaches underlying their merger control policies are different. The US antitrust law has been heavily influenced by the Chicago school economics, according to Rosch.[30] For example, the 1984 US Merger Guidelines are almost always efficiency-enhancing, a tenet of the Chicago school. For merger control in general, efficiency consideration is not yet a defense for an otherwise illegal merger. However, there is increasing evidence that efficiency claims have had the effect to persuade DOJ and FTC not to challenge the proposed mergers.[31] In contrast, the EU Guidelines draw heavily from post-Chicago economic theories.[32] For example, Elhauge has

---

[27] Id.

[28] See the EU Guidelines, ¶119−21.

[29] Michal S. Gal, *Competition Policy for Small Market Economies*, Harvard University Press (Boston), at 239 (2003)

[30] See Rosch, fn. 13.

[31] Robert Pitofsky, *Efficiency Consideration and Merger Enforcement: Comparison of US and EU Approaches*, 39 Fordham Int'l L.J. 1413, 1418 (2007).

[32] Jeffrey Church, *The Impact of Vertical and Conglomerate Mergers on Competition* (2004), at 241−59, at http://ec.europa.eu/competition/mergers/studiesreports/mergerimpact.pdf (last visited Dec. 18, 2012).

presented scenarios in which levering monopoly power can not only reduce consumer surplus through price discrimination, but also cause significant foreclosure effect in the leveraged market.[33] In this situation, both the competitive process and consumer welfare would be impaired. Post-Chicago school thinking appears to be reflected in a number of EU decisions.[34] However, the EU argues that they adopted the same economic analysis as the US.

Secondly and more importantly, the merger control regimes of the EU and the US do not serve exactly the same goals. The US law is pro-competition, believing that the competition process is worth protection as it brings about better products and more choices.[35] The EU law serves the prime goal of market integration in the EU.[36] This is as much a politics as an economic enterprise in Europe.[37] EU Member States possess different degrees of productivity. Economically better-off countries foster more conglomerate firms. This renders domestic enterprises in other countries more difficult to survive in the common market. If a country is so indebted that it has to leave the Euro Zone, this would diminish the primary goal of the EU competition law. That explains why the EC is more willing to prevent anticompetitive conglomerate mergers.

Thirdly, the US merger control pays more attention to coordinated interaction than to unilateral effects. Unilateral effects were firstly adopted only in 1992. The EU merger control traditionally focused on the prevention of creating or strengthening a dominant market position. It was only when the European Union Merger Regulation was revised in 2004 that the substantive test became "significant impediment of effective competition." That was when the coordinated effect became a ground to find illegal mergers in the

---

[33] Einer Elhauge, *Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory*, 123 Harv. L. Rev. 397, 414 (2009).

[34] See Rosch, fn. 13 at 12.

[35] See Robert Bork, *The Antitrust Paradox: A Policy at War with Itself*, Basic Books (New York), at 51 (1978); Richard A. Posner, *Antitrust Law* (2nd edition), University of Chicago Press (Chicago), at vii–x (2001).

[36] Rodger, *Competition Policy, Liberalism and Globalization: A European Perspective*, 6 Colum J. Eur. L. 289, 304 (2000).

[37] See Cheng, fn. 8 at 474.

EU.[38] Therefore, the EU law in action focuses more on examining the change of market structure resulted from proposed mergers. Divergent cultural norms mean that firms and consumers behave differently in the two continents, and therefore, may have different implications on the competition law enforcement across the Atlantic.[39] Competitors may respond more quickly as the EU market becomes more integrated. As coordinated behavior has greater impact on competition, it is expected that foreclosure theories will strike a new balance between the examination of post-merger structure change and coordinated behavior.

Harmonization of competition jurisdictions has collected consistent efforts in recent years. Theories and practices pertaining to conglomerate merger control attracted much debate after the EC declared the proposed GE and Honeywell merger incompatible with the common market. There is much literature advocating for convergence,[40] which is beyond the scope of this paper. Since divergent socio-economic environment and cultural norms have influenced the US and the EU to arrive at divergent rules and enforcement practices. It would be wise for emerging jurisdictions to start from the good practices of established jurisdictions and feel free to arrive at a regime that reflects their socio-economic environment and suits their developmental needs. In fact, legislative societies in a democratic society are no less affected by the community norms than any global uniform goods practices.

4. GE/Honeywell: A Landmark Disapproval. — GE/Honeywell is an exceptional case where the merger between GE and Honeywell was approved in the US, while prohibited by the EU. GE was dominant in producing jet engines, and Honeywell had market power in complementary avionics and non-avionics parts. According to European Commission (EC), the bundling of engines and avionics and non-avionics parts by the merged company would result in creating a dominant position in supplying the complementary

---

[38] Id. at 467.

[39] Thomas K. Cheng, *Culture and Antitrust*, in *The Global Limits of Antitrust*, Loannis Lianos & D. Daniel Sokol eds., Stanford University Press (Palo Alto), 2012.

[40] See Thomas L. Ruffner, *Failed GE/Honeywell Merger: The Return of Portfolio-Effects Theory*, 52 DePaul L. Rev. 1285 (2002–2003); B. Nalebuff, *Bundling and the GE/Honeywell Merger*, Working Paper (No. 22), Yale School of Management (2002).

parts and strengthening GE's dominance with more attractive package offers.[41] Moreover, GE could leverage its financial power to allow Honeywell to take greater risks and give greater discounts to customers, and therefore, subsequently force out their rivals.[42] The merger was therefore prohibited as it posed significant impediment to effective competition in the relevant markets.

The decision has received strong opposition from the US. In commenting on the case, then Deputy Assistant Attorney General William J. Kolasky further elaborated the divergence between merger control enforcement of the two jurisdictions.[43] In the US, market capitalization has been considered irrelevant with non-horizontal merger analysis after the entrenchment theory was deleted from the 1982 Guidelines.[44] Even though GE had the global largest market capital which would allow them to take greater risks and give greater discounts, the US did not give this as much weight as the EC to indicate a likelihood of carrying out post-merger predatory conducts.

Whether Honeywell would get cheaper capital from GE is a matter of fact. To what extent enhanced financial strength would contribute to the incentive and ability to engage in predatory activities is a matter of degree to be considered against the market as a whole. The EC noted that "engine and components suppliers compete on innovation for future products on the basis of R&D expenditures that have to be financed by current and expected cash flows."[45] Therefore, reduction of output would reduce the extent of investment in R&D. The EC considered primarily the likelihood of a technical bundling to successfully eliminate competitors, and then the effect of improved financial strength.[46] Therefore, one way to see the divergence may be that financial strength was no more than an ancillary factor in the EC's decision and its relevance could vary according to the relevant markets in question.

Secondly, the argument that competitors would be forced to exit because

---

[41] GE/Honeywell, fn. 25, ¶416, at 100.

[42] Id. ¶406–11, at 98–99.

[43] See Kolasky, fn. 22.

[44] Id.

[45] GE/Honeywell, fn. 25, ¶403, 97.

[46] Id. ¶ 405, at 98.

they could not achieve a minimum economy of scale has no longer held water in a predatory claim in the US since 1890s. However, it is a ground to find foreclosure in the EU Guidelines. In this regard, EC gives the same weight to foreclosure of incumbent competitors and potential entries in order to protect effective market competition. Whereas the US does not think it a good idea to protect competitors, rather to be alert of increased entry barriers which are considered enough protection of competition. However, except in emerging industries, it is very difficult for fresh new entries to compete with incumbent dominant firms. It is easier to compete with expertise in a familiar market and with the acquired power. If competitors' incentive to compete is reduced, it is very difficult to resume competition in a timely manner. It also takes time for new entries to develop products and establish their market power before it could contribute to effective competition. It is more difficult to protect consumer welfare once the dominant firm has acquired or maintained its power. That is the reason for protecting competitors, as it is necessary for protecting effective competition and consumer welfare.

Regarding the effect on the tool kit market, the US held the view that the purchase of GECAS was less than 10% in the overall market, a merger of a small purchaser and the supplier would not command market foreclosure of its rivals. This is arguably not the market power threshold to infer foreclosure effect. In International Salt, despite the dominant salt supplier had less than 5% share in the salt machine market, their attempt to tie the two products was held to be anticompetitive as it would result in substantial foreclosure in the salt machine market. Moreover, a 10% buyer power could be significant in the merger assessment of all types. In a market of high degree of concentration, a 10% buyer could empower a small firm to reduce market concentration. On the contrary, a loss of 10% share to a dominant firm would drive a number of small firms out of the market and reduce the incentive of new entries because of the enhanced market concentration.

The US lawyers also criticize the EC for reaching the conclusion without empirical evidence that bundling creates advantages for the emerged firm and leads to exit of competitors from the market. According to Patterson and Shapito, such integrated firms with diverse product lines do not necessarily create market power.[47] Where a market is characterized by highly

[47] Donna E. Patterson & Carl Shapiro, *Trans-Atlantic Divergence in GE/Honeywell: Causes and Lessons*, 16(1) Antitrust 18 (Fall 2001).

differentiated products, powerful buyers and individually negotiated transactions, product bundling does not create an advantage.

II. A CLOSER LOOK AT THE EU NON-HORIZONTAL MERGER GUIDELINES

The EU Merger Regulation prohibits mergers that would result in significant impediment to effective competition in the market.[48] Two types of anticompetitive effects are set out in the EU Guidelines, namely unilateral effects and coordination effects. The unilateral effects mean foreclosure of competitors in competition. The coordination effects mean tacit collision to reduce competition. Once a substantial competitor has been removed from the market, coordination could happen between incumbent competitors for fear of being the next one leaving.[49] This is contingent on successful foreclosure in the first place. As multi-market competition is increased after the merger, the conglomerate parents of merging entities would compete less actively in other markets.[50] This might be perceivable for a small economy where there is a high concentration of ownership.[51] This paper will mainly focus on the assessment of unilateral effects — examine the "3-step" test developed by the EC, followed by literature review from the theoretical perspectives.

A. Assessing Unilateral Effects: "3-Step" Test

Unilateral effects arise when the merger results in change of market structure that has anticompetitive effects. Foreclosure is a main concern. The 3-step test examines (a) whether the merged entity will have the ability to foreclose competitors, (b) whether it has the incentive to do so given the profitability of the practice, and (c) whether the foreclosure effect is significant, either driving out a substantial number of competitors from the

---

[48] Regulation (EEC) 4064/89 of 21 December 1989 on the Control of Concentrations between the Undertakings, 1990 O.J. (L 257) 13.

[49] The EU Guidelines, ¶120.

[50] Id. ¶121.

[51] See Gal, fn. 29 at 239.

market or causing them to compete more costly. The first two questions serve the same purpose to assess the likelihood of the entity engaging in exclusionary conduct after the merger. Assessment is based on economic factors that present in the circumstances of each case, with the EC bearing the burden of proof. The third question defines the orthodox rule of "significant impediment of effective competition" in this specific context. The Guidelines also address economic considerations that could give rise to both anticompetitive and precompetitive effects. The "3-step" test is not one easy to apply in all circumstances.

B. The Harm Theories: Market Power Leveraging and Foreclosure

According to the EU Guidelines, foreclosure would arise when the merged firm leverages its power from one market where it holds a dominant position to another market though conditional selling such as tying and bundling products or other exclusionary activities.[52] In this case, foreclosure happens in the leveraged market. The EU Guidelines leave it open that foreclosure may also happen in the dominant market.[53] Tying and bundling of products are very likely, as the tied/bundled products could have been sold to the same range of consumers as the tying/bundling ones.

1. Commercial and Technical Tying. — In the case of tying, purchase of the dominant product is conditioned on the fact that consumers will also buy the other product from the company. Downstream retailers feel obliged to accept the tie if the tying product is something they have to stock in large quantities to satisfy consumer needs. Alternatively, if the tying product is designed in a way that the tied product is the only one of complements of the same kind that is compatible with it, then the technical tying gives the tied product an absolute competitive edge in the market.

2. Fixed and Mixed Bundling. — In the case of fixed bundling, consumers could buy products in fixed proportion at a lower price than buying them

---

[52] The EU Guidelines, ¶93.

[53] For example, in GE/Honeywell, one of the grounds for disapproving the proposed merger was that bundling of engines produced by GE and the avionics and non-avionics parts produced by Honeywell would strengthen the dominant position of GE with more attractive package offers. In Boeing/MaDonnell-Douglas, the merger was approved on the condition that Boeing would limit its newly-gained bargaining power.

separately. Mixed bundling allows consumers to buy two products, either in proportion at a discount or separated without discount. In practice, mixed-bundling is the main concern in most conglomerate merger assessments.

There are two important concepts: complementary products and Cournot effect. Complementary products are products that are often consumed together. For example, tennis bats and tennis balls are complements. Cournot effect gives the merged firm the ability and incentive to price aggressively low in one product, so that sales of the complement will also be increased. The firm will be able to maximize their profits through bundling, though one is priced lower than before the merger.[54] Despite that consumers may get direct benefits from the pricing efficiency in the short run, the reduction in sales may reduce their rivals' ability and incentive to compete and foreclose them from the market.[55] This may allow the merged firm to acquire and maintain market power. However, Cournot effect in itself increases pricing efficiency. Some benefits are immediately transferred to consumers, unless being used as part of a predatory strategy.

Where there is a significant foreclosure resulted from a merger, rival firms would be unable to constrain the merged firm from increasing prices in the long run.[56] This would significantly impede effective competition and harm consumer welfare.[57] On the other hand, if there remain single-product players in either market, competition is unlikely to be deteriorated after the merger. The same holds when few single-product rivals remain, but they have the incentive to expand output. There is a high standard of proof on the side of the Commission.[58]

The EU test of foreclosure requires exit or marginalization of competitors. Competitors lose their profits or markets to an extent that they reduce the incentive to compete. On the other hand, the merged firm will enhance their power and be able to increase prices in the future. In the US law, the *Areeda and Turner Treatise* defined exclusionary conduct as "conduct, other than

---

[54] See Church, fn. 18 at 1540.

[55] The EU Guidelines, ¶93 and ¶111.

[56] Simon Bishop & Mike Walker, *The Economics of EC Competition Law: Concepts, Application and Measurement*, Sweet & Maxwell (London), at 458−59 (1999).

[57] The EU Guidelines, ¶113.

[58] *Tetra Laval*, 2005 E.C.R. I−987, ¶44; *see Gen. Elec.*, 2005 E.C.R. II−5575, ¶ 66.

competition on the merits or restraints reasonably 'necessary' to competition on the merits, which reasonably appears capable of making a significant contribution to creating or maintaining monopoly power." Prima facie, exit or marginalization of competitors is not required. A more straight-forward test is whether competitors are barred from cost-effective ways of competition.[59]

Despite the prima facie divergence of the tests, consistent competition law enforcement requires adopting the same test for foreclosure or predation in merger control as established in conduct rules. Down to the earth, whatever qualifies anticompetitive effect resulted a particular conduct is, and should be, the same, regardless of whether there is a merger beforehand. Therefore, to the extent that the same type of conduct is concerned, it would be necessary to maintain the unity of test in merger rules as in the corresponding conduct rules.

Elhauge argued that foreclosure effect is possible whether or not the unbundled price for the bundling product exceeds the "but for" level (i.e. the price that would have been charged "but for" the bundling). This is noteworthy expansion of the *predatory pricing* theory on foreclosure. Criticism is that this rule is both inapposite to consumer harm and inadministrable and that both "linked" market foreclosure and a form of below-cost pricing are necessary for anticompetitive harm and should therefore be prerequisites to antitrust liability.[60] It is submitted that Courts should recognize a safe harbor for any bundled discount that results in *above-cost pricing* that could be matched by an equally efficient, single-product rival, if *above-cost pricing* might attract liabilities under the conduct rules. [61]

Elhauge also argued that through price discrimination, tying may enhance the tying market power as well.[62] This enhanced a traditional view that price discrimination in a tying arrangement will have exclusionary effect on competitors. Though price discrimination is not a ground to prohibit mergers in the absence of proof of foreclosure, Elhauge's theories pave the way for

---

[59] Microsoft, 253 F.3d, at 64.

[60] Thomas A. Lambert, *Appropriate Liability Rules for Tying and Bundling Discounting: A Response to the Death of Single Monopoly Profit Theory*, 72 Ohio St. L. J. 909 (2011)

[61] Id.

[62] See Elhauge, fn. 33 at 400.

the EC to make a thorough competition analysis in relation with price discrimination.

C. Likelihood of Foreclosure: Economic Considerations

1. Ability to Foreclosure. — The ability to foreclose comes from a strong market position in at least one market, even though a dominant position is not required.[63] Post-merger unilateral conducts are no longer subject to the rule of agreement. Predatory conducts which otherwise are carried out by two firms could be free from liability if the firm lacks monopoly power. Setting the market share standard in between two lines of conduct rules serve two purposes.

It reduces a firm's temptation to avoid liability of entering into anticompetitive agreement through merger. On the other hand, it fully takes into account the fact that unilateral conduct would otherwise not be challenged in the absence of dominance. Therefore, pre-merger assessment of post-merger conducts requires "a strong market position" in at least one market. Post-merger market shares below 30% and the HHI below 2000 are within the *safe harbor* free from assessment.[64]

However, merged firm's attempt to leverage its power across its product portfolio may be more easily disrupted where the portfolio is promoted by downstream retailers, especially where the retailers have private label brands of their own. They can implement counter strategies by giving the portfolio less visibility and less shelf space even if they have accepted the commercial tie in the first place.[65] It would be fair to take buyer power into account, especially for analyzing competitiveness at the retail level. On the contrary, exclusive retail premises feature Amway's business model to avoid competitiveness being diluted at the distribution level. To the extent that counter strategies are effective, other firms would merger more aggressively increasing market concentration as a result. Alternatively, they could enhance the product portfolio through extensive coordination, triggering further

---

[63] The EU Guidelines, ¶99.

[64] Id. ¶23−25. In Hong Kong, one may expect the safe harbor below 25%, as 25% could qualify a dominant market position under the Competition Bill.

[65] See Bishop & Walker, fn. 56 at 456.

concerns about coordination effects.

2. Incentive to Foreclosure. — Whether the merged firm has the incentive to engage in tying and bundling to foreclose competitors depends on the profitability of a foreclosure strategy. In practice, mixed-bundling is the main concern in most conglomerate merger assessments. A bundling strategy profits from share-shifting of sales from competitors in the bundled product market which is sold at a lower price. If there is a higher degree of complementarity between the products, it is more likely that the negative cross-price elasticity will lead to larger sales of the bundled product. Cournot effect is likely to realize.

While, if the bundled product has a relatively low value, then the benefits from bundling will likely be limited. In this case, long-run profits exist in the successful foreclosure of competitors and the likelihood to raise price in relevant markets with its increasing power. It is claimed that in the absence of any significant Cournot effects and the absence of any greater scope of price discrimination, any competitive harm based on mixed bundling boils down to an allegation of predatory pricing.[66]

Whether there is a foreclosing strategy is largely relied on whether there is a real likelihood of success. Financial advantage would increase a firm's incentive to foreclose, because they would be capable to face with risks and there is a higher likelihood of success as predatory bundling lasts longer. On the other hand, financial disadvantage will decrease small firms' ability and incentive to compete in threat of predation.

The merged firm may even incur loss of profits and market shares in the leveraging products, as consumers who view less value in the leveraged product than the comparative advantage of the leveraging product over its substitutes would turn to a substitute as a result.

3. Likelihood to Foreclosure. — The Guidelines recognize, in general terms, some economic considerations relevant for the successful implementation of predatory practices under Paragraph 101.

> *101 "Generally speaking, the foreclosure effects of bundling and tying are likely to be more pronounced in industries where there are economies of scale and the demand pattern at any given point in time has dynamic*

[66] See Bishop & Walker, fn. 58 at 458

implications for the conditions of supply in the market in the future. Notably, where a supplier of complementary goods has market power in one of the products (product A), the decision to bundle or tie may result in reduced sales by the non-integrated suppliers of the complementary good (product B). If further there are network externalities at play this will significantly reduce these rivals' scope for expanding sales of product B in the future. Alternatively, where entry into the market for the complementary product is contemplated by potential entrants, the decision to bundle by the merged entity may have the effect of deterring such entry. The limited availability of complementary products with which to combine may, in turn, discourage potential entrants to enter market."

Economy of scale is an indicator of efficiency. As production output increases, if the producer's average per unit cost reduces, there is economy of scale. Where fixed costs are large, a producer needs to acquire a minimum market in order to produce at below-or-equal cost level to survive. According to Bain, economy of scale is the second most important sources of barriers. Product differentiation is the most important barrier.[67] Tying and bundling foreclose the competing complement supplier from selling into the market where the two goods are consumed together. If economies of scale are such that the sales into the independent market are too small to sustain the supplier, it will either exit or not enter.[68] This is an example of economy of scale and product differentiation, which affect competition together.

(1) Entry barriers. The industrial practice of selling range products in a system can create entry barriers to the disadvantage of suppliers of a single product. Tying or bundling is used to create barriers and eliminate competition in complementary products market.

Whinston (1990) was the first to re-examine and resurrect the role of tying as an entry deterrent.[69] He recognized that the Chicago School's criticism of leveraging monopoly power from market A to market B applies only if market B is perfectly competitive. Whinston demonstrated the advantages of bundling when the incumbent firm has a monopoly in A and B

---

[67] Joe S. Bain, *Industrial Organization*, Wiley (New York), at 248−53 (1959).

[68] See Church, fn. 32 at xxv.

[69] Michael. D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 Am. Econ. Rev. 837, 859, (1990).

and seeks to discourage a potential competitor in B with a superior product (or lower cost). In his model, bundling commits the monopolist to being more aggressive against an entrant, and this commitment discourages entry. However, this strategy requires a commitment to bundle.[70] Because superior complement goods offered by new entrants could consequently allow the incumbent to charge a higher price for its dominant primary goods. If the surplus increase is no less than the monopoly profits from deterring entries, then the incumbent would prefer to abandon its bundling strategy when entry occurs.

Carlton and Waldman (2002) consider how a dominant firm might use tying of complementary products to deter future entry into its monopoly or the primary market. Carlton and Waldman consider the system is composed of two goods that are consumed in fixed proportions. In one variant there are fixed costs associated with the introduction of both products. In the other variant, fixed costs of introducing the complementary product are zero, but it is characterized by direct network effects.[71] For the tie to be effective of precluding new entrant, it must be the case that the rival system producer is not able to enter both primary and complementary markets or recover the fixed costs of entering both in future.[72] Tying is profitable for the incumbent monopoly when the loss profits today from not sharing in the surplus increase created by the entrant's superior complement is less than the monopoly profits it preserves from deterring entries.[73] Carlton and Waldman's finding echoes with Whinston. Tying and bundling could create entry barriers and exclude competition. They would probably be carried out in the pursuit of monopoly profits by monopolistic firms.

(2) Dynamics. Exception to the Chicago School argument arises when the bundle or tying requirements end up changing consumer preferences or production costs, in the latter case, either by achieving scale or scope economies for the bundling firm or by denying scale to rivals. Dynamics of

---

[70] B. Nalebuff, *Bundling, Tying and Portfolio Effects: Part 2 — Case Studies*, DTI Economics Paper No. 1 (London), at 26 (2003).

[71] A direct network effect exists if the benefit from a product is increasing in the number of consumers who purchase compatible or the same product. For instance, as a mobile phone carrier has more customers, its services are more valuable for potential customers.

[72] See Church, fn. 32 at 27.

[73] Id.

market condition would further enhance the entry barriers that could be created by tying and bundling.

Bundling and tying of complements are often used to eliminate competition in complementary products market, arising in the context of vertical integration. Rivals or potential entrants will be at a competitive disadvantage in pricing (or supplying) their product to consumers, as they will not have equal access to the required complementary product or products unless they supply them themselves. For example, if incumbents tie service to the sale of a machine, this may eliminate independent service providers. Entrants would then have to build a rival machine and a rival service network in order to compete in the market. The way in which competitive advantage is gained is subtle in that it works through ancillary effects that do not immediately manifest. For example, the independent service market may not disappear immediately. Even if it does disappear, competition for the initial sale of machines may hold down the lifetime cost of the machine. But the lack of potential competition from entrants can change the incumbents' incentives to raise prices in a repeated game. It is by moving from a static to a dynamic perspective that the incentive to engage in a tied sale arises and the Chicago argument is avoided.

4. Market Concentration. — Different from other factors describing how the market would function, the level of concentration describes market structure. Market structure embodies the framework, conditioning environment or situation within which the behavior of enterprises takes place. According to Bain, behavior is strategically influenced by certain characteristics of the organization of the market. There is a strong correlation between high levels of concentration and barriers and monopolistic excess profits.[74] The theory has been endorsed by the US Supreme Court in Consolidated Foods,[75] while later on the US enforcement agencies it is almost abandoned by the practice to challenge a merger on structural analysis. In recent years, the theory has seldom been invoked in the US and neither does it appear in the EU Guidelines.

However, industries in small economies are likely to be highly concentrated

[74] See Bain, fn. 67 at 296.

[75] *FTC v. Consolidated Foods*, 380 U.S. 592 (1965).

with only a few active firms where economies of scale are present.[76] Concentration has a greater role to play in terms of influencing firm behavior, especially coordination behavior in small economies.[77] Therefore, it cannot be disregarded in competition legislation and enforcement in small economies, if not all economies. Literature in the 1960s provides some serious thoughts of competition effect relevant to market concentration.

Dynamic, rather than static structural, evidence may permit competition inference. Competition cannot be inferred directly and exclusively from structural evidence, as most markets are not purely competitively or purely monopolistic under which circumstances equilibrium conditions do not permit inferences of behavior. However, changes in the market structure may suggest the direction of change in the level of competition.[78] As a matter of proof, it always requires a high probability of changes in the key structure variables for the inference to be drawn.[79] This would require a significant impact on competition.

The next question is in what circumstances conglomerate mergers would be able to affect the market structure. According to Narver, where the market is concentrated or highly concentrated, a change in the market structure needs something that qualifies a significant "shock." So, the acquired firm has to have "a relatively high magnitude of conglomerate merger power."[80] One possibility is that synergy effects arise and benefit the merged entity to a significant extent, usually through exploiting the increased product differentiation.[81] This would allow the merged entity to improve its sales promotion, engage in R&D to improve products and realize Cournot effect in selling complementary products. Narver further qualified the scenario in that if the acquired firm has been relatively large in the concentrated market, then the merger would make the market more oligopolistic and lessen competition.

---

[76] See Gal, fn. 29.

[77] Id. at 239.

[78] Narver, *Conglomerate Mergers and Market Competition*, University of California Press (Berkeley), at 121 (1969).

[79] Carl Kaysen & Donald F. Turner, *Antitrust Policy: An Economic and Legal Analysis*, Harvard University Press (Cambridge), at 121 (1959).

[80] See Narver, fn. 78 at 125.

[81] Id. at 122.

It seems that "conglomerate merger power" is different form market power. Some significant portfolio powers of the acquired firm may come close.

The 1960s' theories were based on synergy effects, which are considered, prima facie, efficient and competition-neutral for today.[82] Mergers during that period were mostly challenged for improved advertising tactics and sales promotion strength. These are very unlikely to be valid ground for imposing antitrust liabilities 50 years later. Despite the limitation, an objective assessment of synergy effects is closely correlated to the likelihood of successful foreclosure. The analysis framework could be helpful for assessing foreclosure effects in relation to predatory concerns.

To the extent that market concentration is considered in the way as Narver suggested, it might even narrow the scope of liabilities and impose a higher burden on the Commission to prove that the conglomerate merger would have as significant impact as to qualifying a "shock" to the existing concentrated structure. On the other hand, increased concentration is evidence for oligopoly. If the enforcement agencies are determined to deter oligopolies, market concentration could be adopted as static evidence. Where a foreclosure is proved to be likely, agencies may be more assured that the anticompetitive effect would be significant.

Gal has identified that coordinated effect is more likely to happen in small economies in response to conglomerate mergers. As a comparison with the EU Guidelines, author focuses on coordination between conglomerate parents of the merged subsidiaries.[83] Such coordination would restrain competition in other markets if the business of the merged entity is substantial for their parent conglomerates. It is to note that, coordination of the parents goes beyond activities such as tying and bundling of their products.

5. Trade-Off Balance between Anticompetitive Effects and Efficiencies. — It is noted that economy of scale, system selling and dynamic demand-supply implications result in efficiencies that are more immediate and certain.[84] Pricing efficiency may arguably cause predation. But efficiency in reducing

---

[82] Korsnan/AD Cartonboard, European Commission Press Release, IP/ 06/610, released on May 12, 2006.

[83] See Gal, fn. 29 at 239.

[84] See Kolasky, fn. 22 at 533.

production costs, improving quality and providing range products should not be the direct basis for condemnation. The Commission needs to establish that there is a high probability that anti-competitive effect will occur rather than a suspicion that they might occur. It must quantify the effect and show that they will result from the merger rather than from pre-existing market conditions.[85] In discharging the burden, there is a necessary trade-off between anticompetitive effects and efficiencies.

The EC has not rejected a merger on the ground of conglomerate effects after GE/Honeywell. Some otherwise anticompetitive mergers were allowed to be conditioned on the firm's compliance with remedial proposals such as compulsory licensing and interest dispersion arrangement. The Tetra Laval/Sidel (2001) merger was approved subject to compulsory licensing. Boeing/McDonald Douglas (1997) was approved on conditions that designed to make Boeing's use of R&D funding transparent and to limit its newly-gained bargaining power. The Coca-Cola/Carlsberg (1997) merger was approved on the condition that the merged entity divests its interest in a bottling company and a Cola brand in Denmark. A remedial measure has become a very useful tool for preventing post-merger violations of competition rules.

6. The Commission Has a High Standard of Proof. — Taking all the complex considerations into account, the Commission has a high standard of proof that the merger would result in foreclosure of a significant share of competitors from the market which amount to a significant impediment of effective competition. Given that conglomerate merger assessment is a prospective analysis and the chains of cause and effect are dimly discernible, the quality of the evidence relied on by the Commission to support the conclusion is particularly important.[86] The Commission needs to establish that there is a high probability that the anti-competitive effect will occur rather than merely that they might occur. This is the consensus between the US and the EU regulators.[87]

---

[85] Gen. Elec./Honeywell, European Commission Decision of 3 July 2001, Case No. COMP/M.2220, at http://ec.europa.eu/comm/competition/mergers/cases/decisions/m2220_en.pdf (last visited Nov. 18, 2012), upheld in part in Case T−210/01, *Gen. Elec. Co. v. Comm'n*, 2005 E.C.R. II−5575.

[86] *Tetra Laval*, 2005 E.C.R. I−987, ¶44; see *Gen. Elec.*, 2005 E. C.R. II−5575, ¶66.

[87] See Church, fn. 18 at 1514, 1517 and 1518.

III. DEVELOPING A CONGLOMERATE MERGER CONTROL REGIME IN HONG KONG

The new Competition Ordinance provides for a sector-specific merger control regime. Even though the regime has a limited scope of application, it sets out relevant factors to be considered in determining whether a merger would substantially lessen competition. The factors fall into five categories: existing competitors outside Hong Kong, removal of competitors, failing firm, entry barriers and the extent of substitutes, innovation and countervailing power.[88] These are all indicators of market dynamics. Apart from considering the extent, the existence of competitors, failing firms, substitutes and innovation speak for a relatively competitive environment. Removal of competitors to a significant extent could fail the test of "exit or marginalization of competitors" rendering a merger illegal under the EU law. As far as conglomerate merger is concerned, tying and bundling of carrier services with other monopoly products may also create barriers for new entrants in both markets. This section will discuss to what extent the considerations and theories developed in Europe and the US could be applied to Hong Kong markets.

Hong Kong is a small and vibrant economy. Among the Fortune Global 500, there are four companies located in Hong Kong, compared with 148 in the EU and 132 in the US. Hong Kong had a gross product of USD 234.333 billion in 2011, compared with USD 17,610.826 billion of the EU and USD 15,075.675 billion of the US.[89] If the Hong Kong economy is replicated 35 times as larger — it has 140 companies on the list, its gross product is, however, only half as big as the average of the two Continents. This means the so-called freest economy could achieve higher efficiencies, perhaps through an economic reform to empower its small and medium-sized enterprises (SMEs). In fact, supporting SMEs is at the top of the Financial Secretary's Budget Proposal (2012–2013).[90]

---

[88] Schedule 7 of the Competition Ordinance, art. 6.

[89] *Report for Selected Countries and Subjects*, World Economic Outlook Database, International Monetary Fund (2012).

[90] http://www.accaglobal.com/en/member/cpd/strategy/key-prosperity0.html (last visited Nov. 17, 2012).

A. Market Concentration and Removal of Competitors

Prevalent in small economies, high market concentration is also a tradition of Hong Kong. In the colonial era, British trading firm Jardine Matheson aggressively reached consumer markets, acquired industrial leaders and also owned the largest land developer Hong Kong Land.[91] During the 1980s and the 1990s, its land power was broken down by a group of Chinese businessmen, fathers of the few land conglomerates today.[92] The last decade witnessed merges of bus operators, subway companies and airlines, most of which involved in powerful property developers as an acquiring party.[93] Though ownership changed, market concentration remained to be high in the modern history. Oligopolistic supermarket chains Park'N Shop and Wellcome locate business across the territory in high density. They would probably leverage a significant edge in rent and location from their massive land power of the parent firm. As a result, small and medium-sized stores feel it more and more difficult to earn a living on a superior land price. The new Competition Ordinance does not incorporate social objectives such as reducing market concentration and supporting SMEs. Current merger control regime operating in the Telecom sector does not put a brake on agglomeration.

Market concentration is not always regarded as inefficient, especially in small economies where the market size could limit the economy of scale. Hong Kong has only two free-to-air TV licensees — Television Broadcasts (TVB) and Asia Television Limited (ATV). ATV staff protested against the authority to issue new license alleging that including more broadcasters would exceed the market capacity and making people lose jobs. The government contributed to maintain the broadcast market under oligopoly firms, frustrating keen applicants such as City Telecom, who has made hundreds of millions of investment to run a new free-to-air license.[94]

---

[91] http://en.wikipedia.org/wiki/History_of_Jardine,_Matheson_%26_Co (last visited Nov. 17, 2012).

[92] http://www.hkatv.com/infoprogram/07/hkdecode/content31b.html (last visited Nov. 17, 2012).

[93] New World First Bus merged with Stagecoach and consolidated their bus line services on the Hong Kong Island in 2002. In 2007, the Island subway line and the Kowloon subway line were merged into one system after the merger of two companies, known as the MTR-KCR merger.

[94] Amy Nip, *City Telecom Looks to Court over Television License Delay*, South China Morning Post (Nov. 8, 2012).

However, the market is inefficient. Statistics show that ATV has been losing market to TVB in the past two decades, from a share ratio of 7:3 to 9:1.[95] Had the government taken a more open policy for competition, ATV would not have to deter new competitors with a "failing firm" defense for their own today. Even though Hong Kong is a small economy, one should not assume that efficiencies will be achieved under the oligopoly or duopoly leadership of a few. Consumers should have more free choice of free TV programs.

The government leans toward issuing new license. City Telecom offers fixed network telecommunications services and broadband Internet access through subsidiaries as well as pay television programs.[96] The parent company divested telecom services to its subsidiary, probably aware of conglomerate issues in merger regulation.[97] In the assessment of unilateral effects, it is for the enforcement agency to prove a real probability, as opposed to a mere possibility, that predatory strategy would be carried out. This is a high burden of proof, while appropriate to justify the control beforehand. In the absence of a strong market position in at least one market, a merger is unlikely to be condemned. Especially if change in the market structure is regarded as a separate ground for blocking a merger, both firms shall be required to have strong market power. The tests for anticompetitive effects should be consistent with those in corresponding conduct rules, otherwise would cause undesirable burden to enforcement and compliance.

The dynamic market structure analysis discussed in Section II(C)(d) in favor of a conglomerate merger, a merger that would turn moderate-or-highly concentrated market toward an oligopolistic market may not be anticompetitive in the absence of evidence of collusion. Problems arise whenever competing firms are able to limit production and set price coordinately. As a result, firms increase their profits at the cost of consumer welfare.[98] Therefore, Hong Kong should pay more attention to detect

---

[95] Community Development Initiative, *The Predicament of Hong Kong Broadcasting Industry and Its Future Direction*, Aug 2010, Legislative Council No. CB (1)2981/09−10(02)LC Paper No. CB(1)2981/09−10(02).

[96] Company Summary of City Telecom (HK) Limited, at http://www.reuters.com/finance/stocks/companyProfile?rpc=66&symbol=CTEL.O (last visited Nov. 17, 2012).

[97] Id.

[98] OECD Policy Roundtables, (99)25 DAFFE/CLP, at 199 (1999).

anticompetitive coordination behaviors.

B. Entry Barriers

According to Carlton, Waldman and Whinston, tying and bundling of complimentary goods could create entry barriers in both primary and complementary markets, the leveraging firm being a monopoly. Cathay Pacific Airways Limited is a leading international airlines that locates its main hub in Hong Kong, with a dominant share of 43% of passenger traffic out of Hong Kong in 2011.[99] Having acquired a famous local brand, Dragonair, in 2006 and forming the reciprocal-holding alliance with Air China, Cathay Pacific is perceived to acquire a monopoly position in the market of Hong Kong. Its subsidiary Hong Kong Airport Service Limited is reported to have 54% share in ramp service at the airport.[100]

Ramp service is usually provided by airlines rather than the airport and requires a lot of efficient and hardworking staff.[101] Some airlines outsourced this part of service to reduce costs, while Cathay Pacific believes the service standards can only be maintained by training its own staff.[102] Given its deep root in Hong Kong, Cathay Pacific is able to maintain high-standard labor force more cost-effectively than other foreign carriers.

Even though bundling passenger ramp service with a flight ticket is doable, the airlines might be very difficult to create a meaning network for passengers using the service. They would be reluctant to incur significant fixed cost to do this. According to the theories, a tying/bundling strategy would not create entry barriers in the complementary market if there is not a network that can retain consumers when a firm raises price above the "but-for" level. Therefore, Cathay Pacific's "monopolization" in the complementary service market was

---

[99] Bloomberg market data. See Zhuoqiong Wang & Jie Liu, *Cathay Pacific Sees Opportunity from Growth in Mainland Traffic*, China Daily (Mar. 22, 2011).

[100] Interim Report of Cathay Pacific Airways Limited (2012), at http://downloads.cathaypacific.com/cx/investor/annualreports/2012_interim-report_en.pdf (last visited Nov. 17, 2012).

[101] See Airline and Aviation Jobs, at http://www.jobmonkey.com/airline/html/ramp_service.html (last visited Nov. 17, 2012).

[102] See Airline Out-Sourcing, *Is It Really a Financial Saving or a Long-Term Costly Mistake*, at http://www.airlinehubbuzz.com/airlines-outsourcing-really-financial-saving-actual-longer-term-costly-mistake (last visited Nov. 17, 2012).

neither a result of illegal tie, nor even likely to foreclose competitors. Its success in the complimentary service market does not expose them to as much anticompetitive query as conglomerate firms standing on a mighty land power.

Land supply is a government monopoly in Hong Kong. The high land price policy creates a number of real estate tycoons. Sun Hung Kai Properties, Cheung Kong (Holdings) Limited, Henderson Land and New World Development once were regarded as the top four property developers in Hong Kong.[103] The press tends to avoid referring to them this way as the anti-wealthy emotion has become prevalent in the city. They all have made a huge fortune from property development and leasing, and during the past decades, consciously or unconsciously, turned themselves into multi-industries oligopolies through conglomerate merger.[104]

For example, two licensed bus line operators respectively belong to Sun Hung Kai and the New World Group. Ferry licenses are shared between companies owned by the New World Group and Henderson Land. Two oligopolistic supermarket chains are indirectly owned by Cheung Kong and British counterpart Jardian/Hong Kong Land through subsidiaries. Even though these markets do not show network effects, if not on the negative side, it requires significant fixed costs to establish and maintain the bus lines, ferry routes and supermarket supply chains. Once being established, they become barriers to new entrants. The law does not require these infrastructures to be made accessible to other firms even on reasonable reimbursement terms, but rather heighten the entry barriers by means of exclusive licensing. As a result, public transportation services are not competitive in Hong Kong.

Protection of consumer welfare is indirectly achieved by monitoring the financial return to operators, known as the Profit Control Scheme.[105] Since

---

[103] *Property Developers Top Forbes' List of Hong Kong Wealth*, The Wall Street Journal, Jan. 17 2012, at http://www.marketwatch.com/story/property-developers-top-forbes-list-of-hong-kong-wealthy (last visited Nov. 17, 2012). For more statistics about China real estate development, see 亚洲周刊(Asian Journal), at http://www.yzzk.com/htm/events/2011_1000/content.cfm?Heading=36; and see also 香港地产网 (Hong Kong Real Estate Network), at http://www.hkproperty.com/HongKong/News/8753401.htm (last visited Nov. 11, 2012).

[104] For a comprehensive breakdown of the conglomerate kingdoms' business territory today, see Zarathustra, *The Future of Hong Kong Series: Real Estate Tycoon and Monopoly*, Oct. 31, 2010, at http://www.alsosprachanalyst.com/politics-society/the-future-of-hong-kong-real-estate-tycoons-and-monopoly.html (last visited Nov. 17, 2012).

[105] Article 26 of Public Bus Services Ordinance.

1997, the government has taken into account a basket of factors when assessing bus fare levels and maximum permitted returns are 9.7% per annum.[106] Whether the price monitoring is effective would be another question beyond the scope of this paper. The author's experience was that groceries in government-run markets could be priced higher than similar brand goods in the supermarkets. The government may not endeavor or be able to set a competitive market price in all the circumstances.

Even though the literature conditions entry barriers analysis on the leveraging firm's monopoly position, it would be proper for the competition authorities of Hong Kong to think hard if an oligopolistic/dominant market position would be sufficient for a stringent examination of conglomerate merger. Wealth and infrastructure resources are highly concentrated in this society. Putting aside the objectives of reducing public discontentment or making opportunities for the growth of SMEs, if existing conglomerates' expansion into new markets could bring in significant entry barriers as the case for bus lines and supermarket chains, how well could the government expect monopoly/oligopolistic power to be well-tamed by one another? Not long ago, two of the above-mentioned land developers bid at above market price leaving it more uncertain whether the government's newly-imposed stamp duty and property tax would cool down cross-border property transactions in the coming years.[107]

C. Efficiency Considerations

In both the EU and the US, the efficiency defense available for merger in general is deliberately narrowly defined in a way that makes it difficult to establish.[108] In both jurisdictions, there is no record where an otherwise illegal merger was found by a court as legal because of efficiencies.[109] Boeing/MaDonnell-Douglas is a case where the EC has found "commonality

---

[106] Eric Heimark & Helena Lalogianni et al., *Paying for a Cleaner Bus Fleet: How Government Can Break the Log Jam*, Civic Exchange Papers, at 7 (2009).

[107] For the newly-imposed tax policies, see Ansuya Harjani, *Why Hong Kong's Property Crackdown Won't Dent Home Prices*, CNBC Asia, Oct. 29, 2012, at http://www.cnbc.com /id/49593704 (last visited Nov. 17, 2012).

[108] See Pitofsky, fn. 33 at 1423.

[109] Id.

benefits" in the combination of products, but still extracted conditions before it approved the merger.[110]

Gal holds the view that efficiencies in oligopolistic markets are unexploited. Merger is the tool for realizing efficiencies.[111] For small economies, competition law enforcement will face the embarrassment that on the one hand, the economy can support only a small number of firms to compete efficiently with the economy of scale; and on the other hand, there are a majority of small firms that attain only a minimum scale.[112] Thus, cultivating efficient firms also result in the high market concentration in the small economy. When the legislature provides an efficiency defense to strike the balance between efficiency and competition, it should bear in mind that the ultimate aim of pro-efficiency and pro-competition legislation should be the same, which is to promote consumer welfare in Hong Kong. Oligopoly results in loss of welfare according to the total welfare standard and the consumer welfare standard, so oligopolistic market concentration should be prohibited.

CONCLUSION

This research discusses the economic theories and considerations incorporated in the EU and the US conglomerate merger control regimes, noting that the two jurisdictions examines conglomerate merger with different degrees of rigorousness. Hong Kong could draw important lessons from comparing the existing divergence of the Continental regimes. As a small economy, Hong Kong should stringently scrutinize conglomerate mergers which are likely to reinforce market concentration or increase entry barriers. High market concentration creates coordination effects as well as unilateral effects.

---

[110] Commission Decision 97/816/EC in Case No IV/M.877 œ, OJ L 336, 8/12/1997, ¶41,124.

[111] Gal, fn. 29 at 247.

[112] Id.