Merger Control in Iran:
Toward an Efficient Merger Control Regime in Iranian Competition Law;

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Mergers are one the main issues of competition law. Many countries have enacted laws and regulations concerning mergers. In 2007, by the enactment of Privatization Act, Iranian legislators provided the first legal matters concerning the Merger Control Regime of this country. But as could be seen in the paper, the newborn regime has undeniable drawbacks which could be mitigated in light of comparative studies. This paper is composed of three parts. In the first part, the terminology of the mergers will be studied. As the second task, we will discuss the main merger substantive tests of the world. Eventually two rival pre-merger notification systems will be examined.

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Introduction

Mergers[2] have been noticed as a marginal issue of Company Law for a long time. However, by the emergence of modern Competition Law (Anti-Trust) in United States *Sherman Act (1890)*, Lawyers and Economists perceived the merger effects on the market and the peril of disregarding them as probable anti- competitive conducts. Hence at the second attempt, the *Clayton Act (1914)* has been passed in which for the first time mergers explicitly became subject to competition law regulations.

Virtually, Competition Law tries to mitigate the negative effects of the mergers while sustaining the positive ones. This policy has been recognized and followed by most of the countries around the world. *European Merger Regulations (ECMR)* of 1989 and 2004 is one of these successful attempts.

In Islamic Republic of Iran, the significance of mergers in competition law has not been identified until the Act of Implementation of the Constitution's Article 44 Policies *(Privatization Act)* was passed at the parliament in 2007. Merger is the subject of article 1(16), 47 and 48 of this act.

But **to what extent this act is efficient in controlling the anti Competitive effects of the mergers?** This question should be answered in the light of a comparative analysis with both the American and European merger regulations. We will try to answer three main questions in this paper:

1. What are the main types of mergers and what are their differences?
2. Which Substantive Test is normally used by the National Iranian Competition Council (NICC*)* to recognize the anti-competitive mergers? Is it an efficient test in comparison with the western policies -SLC[3] and SIEC[4]-?
3. Is the Arbitrary Pre-notification Regime -Subject To article 49 of *Privatization Act*- as efficient as the Compulsory Notification Regime of American and European Merger Regulations?

Answering these questions may help the Iranian lawmaker revise the merger specific articles of *Privatization Act* according to the efficiency of competition law. Besides, it will make the Iranian merger control regime closer to the well-known competition law regimes around the world.

[2] the term Mergers will also include Acquisition and Consolidation in this paper.
[3] Substantial Lessening of the Competition.
[4] Significant Impediment to Effective Competition.

1) Terminology

Terminology or discussing the fundamental concepts is the first step of any paper. Thus I will examine the term *merger* firstly and then the method of distinguishing prohibited mergers will be discussed in more details. As mentioned above, mergers are studied in two different disciplines: Company Law and Competition Law. Hence, we are faced with many articles in both disciplines trying to explain the term merger appropriate with their objectives. Regarding the differences between the objectives, those disciplines discuss different aspects of mergers. While company law classified the mergers in Merger, Acquisition and Consolidation, Competition law studies mergers in an effect based method disregarding their shape. The dichotomy of formalism and the effect based idea will become clearer in part a and b of this section. At the first step I will briefly talk about the types of mergers in Company law; then in part b the effect based idea and its consequences in the terminology of mergers will be examined further.

a. Mergers in Company Law

Companies have a choice between three methods in order to develop their activities. These three ways are defined as organic or non-organic growth and growth through external instruments. In the first method, companies will either develop their product lines or extend their work geographically. Non-organic method includes mergers and acquisitions which are mentioned as the fastest way for a company to obtain new product lines, new markets and to the new consumers. In the last method, the growth is rendered through licensing and franchising agreements, the JVs or the other strategic alliances.

There are two major sorts of mergers which we will try to define them briefly:

1. Mergers by which at least one firm ceases to exist.

Unilateral mergers and consolidations will stand in the first group. Unilateral merger is a combination of two or more firms in which all but one legally cease to exist (DePamphilis; 2011, 248). Hence in this case, the merged company will lose its legal personality and just survives as a part of the buyer (Brown;2007, 23). This definition has been reflected in the 4th Program Act of Iran (2004) under the title of Unilateral Merger too.

One of the other main sorts of mergers is called Consolidation. The consolidation is a business combination involving two or more companies joining to form a new company, in which none of the combining firms survive (DePamphilis; ibid, 7). Although there is a consensus on the above mentioned definition, some scholars have reduced the term to the unity of a parent company with its subsidiaries or the combination of the subsidiary companies by the parent due to tax purposes (Brown; ibid, 25). Thus the distinctive element of a consolidation from other sorts of mergers is that the former would always result in creation of a new legal entity other than the combining firms. In other words in a consolidation all firms will confront with dissolution (Foltz, Araci and Kargin; 2002, 137) and the new firm will rise from the ashes. It is vivid that the consolidation is just viable through exchange of the combining firms stocks.

2. Mergers in which no changes happen to legal personality of the merging firms.

It seems impossible to include all sorts of mergers in the first category which just focuses on the legal personality. The most significant form of mergers is the case in which a company becomes able to control another. In other words the most popular sort of mergers is the purchase by one company of a controlling ownership interest in another firm, a legal subsidiary of another firm, or selected assets of another firm which is called Acquisition (DePamphilis; ibid, 243)(Gaughan; 2002, 7). Regarding the enhancement in the buyer's power there is no difference between a Unilateral Merger and an Acquisition. Both may enable the new body to negatively affect the market.

There are two major methods for an acquisition. The most common method is purchasing the stocks of the target company by the acquiring firm which is called stock acquisition. Stock acquisition is often done through cash purchase, stock exchange or the combination of the two. Since 1998 there is an emerging trend toward the stock exchange and the combined approach. Hence, purchasers are now less willing to use cash method due to the intolerable risks associated with it.

The second method of acquisition is Asset Purchase. In United States v. Columbia Pictures Industries Inc. (1980) the term asset is defined as anything of value. Being disregarded in Clayton Act (1914) as a kind of mergers resulted in a trend in the firms to use asset purchase instead of acquiring the stock. In other words until the enactment of Cellar-Kefauver (1950) as an amendment to Clayton act, shadow of prohibition merely could cover the stock purchase and the purchase of assets was utilized by some companies for being excluded from the Clayton Act. In 1950 the section 7 of Clayton Act was changed as follows:

No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire ***the whole or any part of the assets of another person*** *engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.*

b. Mergers in Competition Law

As mentioned above, the key element to distinguish mergers in company law is the final situation of legal personality. Competition Law in the other hand never minds the shape of a merger and the legal personality. Mergers in competition law may vary from a unilateral merger to interlocking directorship. Hence the key element to distinguish mergers in competition law is not the mere shape but the ability to control another firm. So, in comparison with the formalist company law, the competition law could be called *Effect Based*. Market is the focus point of competition law and the effect of mergers on the market is of an importance. So, In this part I will try my best to answer two main questions:

1. What is the definition of a merger in competition law?
2. What kinds of mergers are studied in competition law?

As I mentioned above, section 7 of the Clayton Act is the first legal statement in which mergers has been taken into consideration. According to the abovementioned article, mergers in US antitrust have the following specifications:

A. A merger must occur between at least two firms
B. A merger is direct or indirect purchase of stocks or assets; horizontal or non-horizontal
C. A merger which results in Substantial Lessening of the Competition could be announced prohibited.

As it is clear, the aforementioned characteristics of mergers in Clayton Act cover all sorts of mergers disregarding the shape.

In the EU the definition of the term "merger" would be found in article 3(1) of ECMR[5] (2004):

A concentration shall be deemed to arise where a change of control on a lasting basis results from:

a. the merger of two or more previously independent undertakings or parts of undertakings or

b. the acquisition, by one or more persons already controlling at least one undertaking, or by one or more undertakings, whether by purchase of securities or assets, by contract or by any other means, of direct or indirect control of the whole or parts of one or more other undertakings.

In this regulation the word merger is replaced with *Concentration* and covers all sorts of mergers which are studied in company law.

In Iran the most relevant act in which mergers are defined explicitly is Privatization Act of 2007. The act in article 1(16) explains the meaning of the term *Merger*:

Merger is the activity under which several companies form a single legal personality by eliminating their own legal personality or become absorbed in a new one.

As it is vivid, unlike the US and EU laws it merely recognizes the legal personality based notion of mergers. In other words the article just discusses unilateral mergers and consolidations and never notices the acquisition. In the other hand in article 47 the Iranian lawmaker creates a confusing condition:

No legal or actual person shall acquire capital or stocks of companies or firms if it harms competition in one or several markets.

There is an inconsistency between article 1 and 47. Although there is nothing about an acquisition in article 1, the lawmaker has decided to prohibit anti-competitive acquisitions in article 47. It is possible indeed to reconcile both articles by giving another interpretation for the article 1:

1. The stipulation of *by eliminating the legal personality* just refers to *form a single legal personality* other than *become absorbed in a new one"*. Hence the article defines the consolidation.
2. The provision of *become absorbed in a new legal personality* may include both the unilateral mergers and acquisitions.

But it sounds impossible to reconcile article 1 and 47 due to another drawback in the former article. The given definition of mergers in article 1 merely comprises the

[5] Council Regulation (EC), No 139/2004 of 20 January 2004 on the Control of Concentrations between Undertakings (The EC Merger Regulation) or ECMR

Company and legal personality other than a *Firm*. A company has its own meaning in article 1(5):

A legal personality which is formed in accordance with the Iranian Commercial Act [1932 or 1968] or special acts whichever applicable.

While in article 47 and in defining a sort of mergers -acquisition- both legal and actual persons -firm- have included, article 1 merely mentions legal persons in defining the large group of mergers.

It seems that the Iranian lawmaker was to divide the terms merger and acquisition. It is clear that when we discuss the mergers, based on the legal personality, we should use the word *Company* and in defining the acquisitions, the *Firm* would be chosen.

As studied above, beside the formalist view which focuses on the legal personality criterion, there is another idea concerning how a merger affects the market. The idea which is based on the term *Market* is the core consideration of the competition law. According to this criterion, there are two major sorts of mergers in competition law:

1. Horizontal Mergers

Horizontal mergers are mergers between parties who operate in the same relevant market (Kokkoris and Olivares-Caminal; 2010, 43). In other words they are those mergers which take place in the same industry or business (DePamohilis; ibid, 12) (Weston and Weaver; 2001, 12). The Oracle and People Soft merger of 2004 and the acquisition of Gillette by Procter & Gamble in 2006 in software and household products markets are two relevant examples of horizontal mergers.

Horizontal mergers often result in decreasing of the competitors and hence reduce competition in the market. The decrease in the number of competitors may cause concentration of power in a market which enables the merging parties to act independent of the consumers. Thus the government as a people-based institution shall endeavor to allocate power in the market by means of competition law. Unlike Iran, there are clear guidelines and regulations concerning the control of horizontal mergers in both EU and US. The 2010 US Department of Justice and Federal Trade Commission's Horizontal Merger Guidelines and the 2004 European Commission Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings are the last versions of these efforts.

2. Non-Horizontal Mergers

This category is divided into two groups of vertical and conglomerate mergers.

Although they always are placed in the second position of significance, the non-horizontal mergers have their own guidelines and regulations in US (1984) and EU (2008).

Vertical Mergers are those which occur in several levels of production (Motta; 2007, 278). The merger between Cisco as a hardware producer, Dow Jones as a content provider and Yahoo or Google as portals would be vertical. The vertical mergers are mostly aimed at decreasing the associated costs of transportation, insurance etc.

The conglomerate mergers comprise firms which are not related and mostly take place in order to diversify their field of activities. The 1981 acquisition of Marathon Oil by US Steel is an appropriate example for conglomerate mergers.

Hence, Merger is obtaining the control of a firm by another firm. No matter the parties are in the same, several or unrelated levels of production and the merger is done through elimination of legal personality or transform the acquired firm to a subsidiary.

Mergers may have both negative and positive goals and effects. In other words, mergers may tend to create market power which could be detrimental to consumer's benefits. In the other hand, merging parties may use the fruits of resulted synergies to work more efficient and benefit the consumers and the whole society. Hence, prohibiting a merger without a cost-benefit analysis same as their unconditional acceptance may be harmful to the consumers and the whole society. Hence the competition authorities should prohibit mergers which their negative effects overweight the positive dimensions.

2) Mergers Substantive Tests

Substantive tests are those examinations which are aimed at distinguishing the anti-competitive mergers from pro-competitive ones. In this part the major tests will be discussed:

a. Substantial Lessening of the Competition (SLC):

SLC is the main test to recognize the anti-competitive mergers in the US. The competition agencies of the US –FTC and DOJ- have provided guidelines regarding the control of mergers since 1968. The latest version of these guidelines concerning the horizontal mergers is published in 2010. In those guidelines, mergers should not be permitted to create, enhance, or entrench market power or to facilitate its exercise. These Guidelines generally refer to all of these effects as enhancing market power which may be harmful to consumer's benefits. With inclusion of *May* in section 7 of the Clayton act:

*The effect of such acquisition **may** be substantially to lessen competition, or to tend to create a monopoly*

The congress created the Incipiency Standard (Broder, 2010, 112) which enables the agencies to scrutinize the mergers even before the negative effects emerge. Indeed, in order to prohibit a merger, the potential negative effects would be sufficient.

b. Dominance Test and Significant Impediment to Effective Competition (SIEC):

The dominance test is the criterion which the article 2(3) of ECMR (1989) expressed as the main examination to distinguish the anti-competitive mergers. Although the Dominance Test has been replaced by the new ECMR (2004), it has influenced the new criterion -SIEC- profoundly. But, as the evolution of article 102 of TFEU, the dominance test had its own drawbacks. The Dominance Test as the main criterion for merger control reflected in article 2(3) of ECMR 1989 as follows:

A concentration which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it shall be declared incompatible with the common market.

The dominance test could manage two sorts of anti-competitive mergers:

a. Mergers which result in creation of the dominant position in the market.
b. Mergers which strengthen the dominant position in the market.

Although these kinds of mergers would be a great part of anti-competitive mergers, it is clear that there is a blind spot in the article. The point has firstly been announced in Kali und Salz v. Commission (1998) was that according to the article, if there is no dominance position there would not be any prohibition. In other words, if a merger has anti-competitive effects but does not create or strengthen the dominant position in the market could not be announced prohibited by the commission. This blind spot emerged as a major problem in Airtours/First Choice v. Commission (2000). The merger which took place in touring industry of Britain would allocate the market to three competitors with market shares 20.4%, 30.7% and 34.4%. Although neither of the firms was able to have a dominant position in the market, the commission prohibited the merger due to creating collective dominance. The commission's idea was not accepted in the Court of first Instance (CFI) because the tacit collusion was necessary in order to create a collective dominance. Hence the commission could not prove that what happened in the Airtours case was non-coordinated effects in an oligopolistic market which could harm the consumers without creating any dominant positions (Kokkoris; 2011, 15).

In order to solve the problem, the new ECMR devised a new criterion in its article 2(3):

A concentration which would significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared incompatible with the common market.

Although there are explicit differences between ECMR 2004 and section 7 of Clayton Act, some scholars use SIEC and SLC interchangeably (Scott; 2006, 79). It is clear that the dominance criterion is still important in European merger control regime; although in accordance with the wording of the article 2(3), it is no longer the main criterion. At the first glance, the combination of SLC and Dominance test sound unreasonable since the former would cover the mergers which result in creating or strengthening the dominant position. Indeed, emphasizing on the dominance criterion has made the European merger control regime a two tired regime within which two phases of evaluations will be applied. In other words, if the dominance test could not recognize an anti-competitive merger, the SIEC will be rendered.

c. The Combined Approach: Certain Anti-Competitive Conducts or Creating the Dominant Power in the Market

Unlike the merger control regimes of US and EU, there is no clear substantive test in Iran. The first policies regarding the control of anti-competitive mergers had been reflected in the article 40 of the 4th Economic, Social and Cultural Plan Act (2004). In this article the Iranian lawmaker stipulates that a merger between companies is allowed as long as it would not result in a concentration and emergence of a monopolistic power.

Hence, mergers in Iran as the other countries are not illegal per se. besides, it is vivid that the word *Concentration* in the article is not analogous to its meaning in European competition law literature which is another term for "merger". Accordingly, concentration in Iranian competition law will be a synonym of monopolistic power.

After the 4th Plan Act, the Act of Implementation of the Constitution's Article 44 Policies –or Privatization Act- passed by the Parliament and the Expediency Discernment Council in 2007 and 2008 which amended the Plan Act. The act in the article 48 enumerates all sorts of prohibited mergers in an exhaustive list as follows:

Mergers between firms or companies will be prohibited in the following circumstances:

a. During or as the result of a merger, the contents of article 45 apply.

b. As the result of a merger, the price of goods or services unreasonably increases.

c. When a merger results in a highly concentrated market.

d. When a merger results in creation of a controlling firm or company.

Now I will examine each provision of the article 48.

A. Article 45 of the Privatization Act:

In article 45, the Iranian lawmaker enumerates eleven practices as per se anti-competitive activities:

a) Hoarding and Refusal to Deal
b) Discriminatory Pricing
c) Discrimination in Trade Conditions
d) Predatory Pricing
e) Misleading Statements
f) Compulsory Sale or Purchase
g) Supplying Non-Standard Goods and Services
h) Interference in the Competing Firms Internal Affairs or Transactions
i) Abuse of Dominant Position
j) Resale Price Maintenance
k) Unauthorized Obtaining and Abusing of the Personal Information and Position.

Although the enumerated activities are not homogenous, the article recognizes all of them as Anti-Competitive Practices. The Misleading Statements, Supplying Non-Standard Goods and Services, Interference in the Competing Firms Internal Affairs or Transactions or Unauthorized Obtaining and Abusing of the Personal Information and Position would not be anti-competitive per se whereas there is no doubt in prohibition of the Abuse of Dominant Position in the market. Hence the article seems to be consisted of both anti-competitive conducts and unfair practices which have been prohibited regardless of their differences. Thus, there is an inconsistency between the content and the article and being per se anti-competitive and illegal.

B. Unreasonable increase in the prices:

Mergers could have price and non-price effects and the article 48(2) expresses the first. The interesting point regarding this criterion is its inclusion in article 45 as an instance for abusing of dominant position. By repeating the criterion of article 45(i) in 48(2), the Iranian lawmaker has expanded the prohibition of price increase to the mergers which do not result in dominant position in the market.

C. Creating a Highly Concentrated Market:

If the fundamental goal of competition law is allocation of power in the market, a highly concentrated market is the most dangerous enemy of competition authorities. The term *highly concentrated market* indicates that moderately concentrated and non-concentrated markets also exist and the prohibited mergers are which may create a highly concentrated market or strengthen concentration in these markets. Concentration is always calculated by Concentration Ratio (CR) or Herfindahl-Hirschman Index (HHI). In Iran no regulations exist concerning the method of calculating concentrations. Although the National Iranian Competition Council (NICC) as the only competition authority of Iran has the duty to prepare and announce the highly concentrated market domain, nothing is published up to now. Thus the article 48(3) would be meaningless without the regulations which define the highly concentrated market.

D. Creating a Controller firm or company:

The *controller firm or company* is defined in article 1(18) of the Privatization Act:

A firm or company which controls economic activities of the other firms or companies by means of wholly or partly acquisition of stocks, assets, management etc.

It is not clear why the Iranian Lawmaker has devised this criterion. In other words, all acquisitions enable the acquiring company to control the acquired firm. Hence it could not be prohibited unless by the controller firm, the legislator meant a monopoly or a firm with dominant position in the market; in this case the prohibition was mentioned in article 48 (1 and 3) and there is no need to be repeated.

3) Pre-Merger Notification

Merger review by competition authorities begins with premerger notification. Then the recognition of the relevant market through Hypothetical Monopolist or SSNIP test will be done. At the third step, the market shares of the undertakings would be identified. Then by means of HHI, market concentration will be recognized. Due to these elements and the mitigating factors, the competition authorities either allow or prohibit a merger. Merger control in Iran has not discussed most of the aforementioned levels. Hence I could not compare the Iranian regime with American or European guidelines in the same subject. Between the levels, merger notification has drawn more attentions in Privatization Act of Iran.

Premerger Notification (PN) was entered into the competition law literature by the enactment of Hart-Scott-Rodino Antitrust Improvement Act (1976) as an amendment to Clayton. The act requires the parties to a merger beyond the certain threshold to notify it to the agencies. The approach was followed in EU since the enactment of ECMR (1989) and more than 70 other countries in the world (Galloway; 2009, 257). If the compulsory premerger notification is an efficient method which prevents anti-competitive mergers, the arbitrary premerger notification would be inefficient and destructive to the whole market. Unlike the compulsory premerger notification, the arbitrary regime brings insufferable uncertainty to the merging parties. In other words, the optional premerger notification allows the competition authorities to intervene and review the mergers whenever they desire. Unfortunately the article 49 of the Privatization Act of Iran indicates the inclination of the Iranian merger policies to the arbitrary premerger notification:

The firms and companies ***could*** *ask the NICC if the articles 47 and 48 apply on their circumstance.*

Conclusion

This paper in three main parts, tried to compare the merger control policy in EU and US with the new merger control regime in Iran. The article started with examining the exact definitions and main types of mergers both in Company Law and Competition Law. Then I tried to evaluate the substantive test of mergers. Although more or less there is a common merger substantive test in US, Europe and most of the countries around the world, Iran has determined disordered criteria which could not fully control anti-competitive mergers. At the final phase of this paper, I briefly studied the pre-merger notification regimes. I tried to make clear that the arbitrary pre-merger notification brings an intolerable uncertainty to the merging parties and hence could not be efficient.

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