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The New E.C. Merger Control Test under Article 2 of the Merger Control Regulation

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I. INTRODUCTION

On November 25, 2003, the Council reached a political accord on amending the Merger Control Regulation. On January 20, 2003, the Council formally adopted the amendment as new Regulation No. 139/2004. On December 16, 2003, the Commission issued a Notice regarding horizontal mergers, explaining the Commission's review criteria. The new regulation and the Commission's Notice will become effective on May 1, 2004. Article 2, Sec. 3 of the new regulation provides: "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."

The former Article 2, § 3 provided: "[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."

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2 Council Regulation 4064/89 EEC of 21 December 1989 on the Control of
The decisive criterion in the former test was the creation or strengthening of a dominant position. The criterion concerning the impediment of effective competition, on the other hand, was accorded little independent significance. The amendment of the merger control regulation has reversed this relationship. Now the sole criterion for disallowance is whether the merger will significantly impede effective competition. The creation or strengthening of a dominant position is listed solely as an example of a significant impediment of effective competition. However, this change, which appears very substantive at first glance, should not be overestimated. Ultimately, the decisive factors in the evaluation of a merger are what merger control seeks to achieve and what criteria are used in reviewing the merger. The primary objective of merger control is still to protect competition against distortion. The review criteria of the first section of Article 2 remain the same. Despite these similarities, however, the new test can lead to different results in individual cases.

This article begins by outlining the legislative history of the new Article 2. That preface is followed by the identification and explanation of the three main reasons for the amendment of Art. 2. First, however, there will be a very brief explanation of the terms used in this article. This is necessitated by the unfortunate fact that, in the general discussion and even in the Commission proposals and the new merger control regulation, the terms are sometimes imprecisely or even incorrectly used.

II. USE OF TERMS

A merger can have either unilateral or coordinated effects. "Unilateral effects" are detrimental welfare effects from mergers, resulting in either the reduction in product volume or the rise in prices by undertakings which act individually and independently of the reactions of other competitors. "Coordinated effects" are detrimental welfare effects which result from uniform and coordinated interaction by individual undertakings.

A coordinated interaction oligopoly is also referred to as collusive.
The term "collusion" can be broken down into tacit collusion and explicit collusion. Tacit collusion does not occur by means of agreements or coordinated behavior within the meaning of Art. 81, Sec. 1, of the E.C. Treaty. Instead, a uniform approach of the members of an oligopoly results automatically from the market structure. The market structure permits the coordination of market actions without trading information. Tacit collusion therefore occurs without coordinated behavior within the meaning of Art. 81 of the E.C. Treaty. In the case of Art. 81 of the E.C. Treaty, the term autonomous parallel behavior is used in order to differentiate these cases from coordinated behavior, which do fall within the scope of Art. 81 of the E.C. Treaty. In contrast, explicit collusion occurs by reason of agreements or other coordinated behavior. Regardless, the end result of both tacit and explicit collusion is the same: no effective competition occurs.

III. LEGISLATIVE HISTORY

Already in its 1998 Green Paper, the Commission raised the question of whether the market dominance test should be continued or whether it would be better to introduce the Substantial Lessening of Competition Test ("SLC test"). In the discussion which followed, the majority advocated a continuance of the market dominance test for reasons of legal certainty. Proponents of the market dominance test pointed out that the results of the SLC test in the United States and the market dominance test in Europe are essentially the same. This position can be summed up with the phrase: "When it ain't broke, don't fix it." There were also significant opposing voices which called for the introduction of the SLC test. This opposition argued that the market dominance test did not cover all mergers which had adverse effects on competition. The market dominance test allegedly had a gap for mergers which resulted in unilateral effects in oligopolistic markets. This view can be described with the phrase: "Mind the gap."

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7 Id.
8 The term autonomous parallel behavior is more precise since the original meaning of the term "collusion" implicates an exchange of information and a coordinated behavior of companies. However, following the common use of terms, "tacit collusion" will be used.
11 Mario Monti, EU Competition Policy, in 2002 FORDHAM CORP. L. INST.. 87 (B. Hawk, Ed. 2003).
The Commission’s proposal for a new Merger Control Regulation of December 2002 provided the following compromise: the former reasons for prohibition would be retained. However, the term “dominant market position” was to be defined in a new Section 2. The proposed new Section 2 provided:

For the purpose of this Regulation, one or more undertakings shall be deemed to be in a dominant position if, with or without coordinating, they hold the economic power to influence appreciably and sustainably the parameters of competition, in particular, prices, production, quality of output, distribution or innovation, or appreciably to foreclose competition.\(^{13}\)

The Commission wanted to retain the market dominance test for reasons of legal certainty. At the same time, with the new definition of dominant position, it wanted to make clear that the market dominance test permits the prohibition of mergers in very specific oligopolistic situations in which the merging undertakings would be able to raise prices unilaterally and to exercise market power without coordinating their behavior (colluding) and without necessarily possessing the largest market share.\(^{14}\) Thus, the definition was meant to close the gap complained of in the market dominance test. Moreover, the new definition was meant to establish a stronger correspondence between merger regulation and the economic effects of mergers.\(^{15}\)

In its response to the Commission’s proposal, the European Parliament proposed that the Commission’s intended definition of market dominance be stricken.\(^{16}\) The European Parliament feared that the new definition would result in more legal uncertainty, rather than in clarity concerning the assessment of mergers, inasmuch as the new definition would apply to almost any merger.\(^{17}\)

Finally, in the Council’s meetings on November 25-26, 2003, a new compromise was adopted. The council agreed to introduce a new test, similar to the SLC test, but with an addition stating that the creation or strengthening of a dominant market position constitutes a substantial impediment of effective competition.

The rationales for introducing the new test can be broken down into

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\(^{14}\) Id. at 54.

\(^{15}\) Id. at 56, n.18.


\(^{17}\) Id.
three distinct goals. First, the new test is designed to close the alleged gap in the market dominance test. Second, the new test is meant to harmonize with U.S. law. Third, legal certainty is assured through the reference to the creation or strengthening of a dominant market position.

IV. MIND THE GAP

The main reason for the modification of the substantive test was the closure of the gap thought to exist in the old market dominance test. The former market dominance test is briefly described here in order to permit a comparison with the new test.

A. The Former Market Dominance Test

Under the former Merger Control Regulation, a merger was prohibited if it resulted in individual or collective market dominance.

(1) Individual Market Dominance

The Commission and the case law define a dominant market position as "a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers."

The question of whether an undertaking after the merger will have the power to behave independently requires an independent examination.

In analyzing a dominant market position, the relevant product and geographic market must first be determined, in order to filter out competitive forces which affect the undertakings involved. The Commission determines the relevant market using the demand market concept. According to this test, products which market opponents view as interchangeable belong to the same market. In a second step, the Commission must decide whether the undertaking has a dominant position in this market. The Commission first looks at the undertaking's market position, and, in doing so, is largely concerned with market shares. Thereafter, the Commission looks at the influence of the opposite side of the market on the merging undertakings, and, in a third step, determines the competitive pressure exerted by potential competitors.

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20 See, e.g., Case No. IV/M053, Aerospatiale-Alenia/de Havilland, 1991 O.J. (L 334) 42;
The decisive element in the review of the individual market dominance is the competitive pressure influencing the undertaking. If such competitive pressure is no longer strong enough, then the undertaking has freedom to act autonomously within the meaning of Art. 2 of the Merger Control Regulation.

(2) Collective Market Dominance

"Collective market dominance" is understood to mean the dominant market position of a number of undertakings which are independent of one another in a reference market. The European Court established in its seminal decision Kali und Salz that merger control may also apply to collective market dominance. According to this decision, several undertakings possess a dominant market position if they "together, in particular because of correlative factors which exist between them, are able to adopt a common policy on the market and act to a considerable extent independently of their competitors, their customers, and also of consumers." This definition contains two conditions: first, the undertakings must have a common market approach. This means that they may not be in competition with one another. Second, the undertakings must be capable of acting independently of external competitors and buyers. Thus, the members of the oligopoly should also not be subject to any significant external competition.

These basic requirements were developed by Commission practice and especially through decisions by the Court of First Instance ("CFI"). That development first took its ultimate shape in the CFI's Airtours decision. The CFI stated in its decision that a collective market domination could result from a merger if that merger, by reason of market conditions and change in the market structure, created a situation where:

each member of the dominant oligopoly, as it becomes aware of common interests, considers it possible, economically rational, and hence preferable, to adopt on a lasting basis a common policy on the market with the aim of selling at above competitive prices, without having to enter into an agreement or resort to a concerted practice within the meaning of Article 81 of E.C. Treaty and without any

Green Paper, supra note 9, at para. 5.
22 Id.
23 Case IV/M.619, Gencor/Lonrho, 1996 O.J. (C 247) 19; Case IV/M.1225, Enso/Stora, O.J. 1999 (L 254) 9; Case IV/M.1524, Airtours/First Choice, O.J. 2000 (L 93) 1.
actual or potential competitors, let alone customers or consumers, being able to react effectively.\textsuperscript{26}

In the \textit{Airtours} judgment, the CFI pointed out that the Commission had failed to provide sufficient evidence for coordinated action. It made unmistakably clear that coordinated action by members of the oligopoly did not require structural connections or coordinated behavior within the meaning of Art. 81 of the E.C. Treaty. Instead, it is enough if the merger so alters market conditions that members of the oligopoly are able to make strategic decisions upon consideration of the likely behavior of the other members of the oligopoly and that there is no longer any effective competition among the members of the oligopoly (tacit collusion).

In order to assume such a dominant market position, the CFI required that the following three conditions be present.\textsuperscript{27} First, each member of the dominant oligopoly had to be able to gain information concerning the behavior of the other members, in order to determine whether or not they were coordinating their actions. For this, the market had to be sufficiently transparent. Second, there had to be a reason for the undertakings to not deviate from such behavior on the market, so that tacit market coordination could occur. This reason was said to be present only if there are adequate deterrents to prevent deviation from the common parallelism. Each member of the oligopoly had to know that any strongly competitive initiative on its part to acquire a greater market share would trigger a similar measure by the other members of the oligopoly, so that there was no advantage to be gained from its initiative. Third, the CFI required that the anticipated response of the actual and potential competitors as well as consumers did not cast into question the anticipated results of the common action.

The essence of the collective market dominance is that, due to conditions on the market, the members of the oligopoly can tacitly coordinate their behavior and can approach the market commonly without regard for their buyers or for those outside the oligopoly. Thus, collective market dominance “only” covers the coordinated effects of mergers.

B. Substantial Impediment to Effective Competition

According to the Draft Commission Notice regarding the control of horizontal mergers, there are three ways in which mergers can significantly impede effective competition.\textsuperscript{28} In the notice passed by the Commission it

\textsuperscript{26} Id. at para. 61.
\textsuperscript{27} Id. at para. 62.
\textsuperscript{28} Draft Commission Notice on the appraisal of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, Dec. 11, 2002, at para. 11, \textit{available at} http://www.europa.eu.int/comm/competition/mergers/review/ (last visited
differentiates between mergers which result in coordinated effects and mergers which result in non coordinated (unilateral) effects. But in the end, in the same notice, the Commission differentiates between three different effects of mergers.  

First, a merger can create or strengthen a dominant market position. This category corresponds to the prior individual market dominance category. The Commission reviews whether an undertaking, by reason of its market position, can behave independently of its competitors. In evaluating the market position, the Commission looks primarily to the market share. It also considers the vertical integration of the undertaking and its economic power and financial strength. Thereafter, the Commission looks at whether the opposite side of the market compensates for the growth of power resulting from the merger and whether competition is still preserved, despite the merger, through new market entries by competitors in the future.

Second, a merger can supposedly change the competitive structure in an oligopolistic market such that market participants that did not previously coordinate their market behavior are now able to coordinate it and therefore are able to raise prices. Moreover, the merger could supposedly facilitate the coordination of market behavior by market participants that have previously coordinated their behavior (colluded). With this category, the Commission covers the “coordinated effects” of merger. This category therefore corresponds to collective market dominance. In its draft Notice, the Commission sets forth the conditions established by the CFI in its Airtours decision.

Finally, a merger can supposedly reduce the extent of competition in an oligopolistic market if it eliminates important competitive barriers for one or more market participants and enables them to raise prices. This can also happen where the oligopolists do not coordinate their behavior. This category is new. It is intended to close the gap thought to exist in the former test. This gap can be illustrated with a simple example. There are four big participants in a given market: participant A and B each have a market share of roughly 15%. Participants C and D each have a market share of roughly 30%. Participants A and B merge. The market is not


30 Id.; see also Draft Notice, supra note 28, at para. 11.

31 Id.

32 Id.

33 Id.

34 See Rationale No. 25 of EC Merger Regulation, supra note 2.
transparent, so that coordination among the remaining three participants cannot be proven. Despite the small number of market participants and symmetrical market share distribution, the merger cannot be prohibited on grounds of collective market dominance. None of the undertakings has individual market dominance since each undertaking still faces two strong competitors. But this merger is *prima facie* anticompetitive. The new category is specifically intended to cover such mergers.

In its Draft Notice, the Commission describes the criteria which serve as the basis for the review of mergers in an oligopoly which do not result in coordinated effects. The Commission states in its notice that a merger raises serious competition concerns only when the aggregate Herfindahl-Hirschmann-Index (HHI) is between 1000 and 2000 and rises by at least 250 points or the aggregate HHI is above 2000 and rises at least 150 points.

The Commission, in its Draft Notice, further distinguishes between markets in which competition exists primarily at the production/capacity level (Cournot Oligopoly Model) and markets in which the decisive competition parameter is the price (Bertrand Oligopoly Model). If the competition is more on the production/capacity level, then, according to its Notice, the Commission will look at whether the reduction of competitive pressure creates an incentive for the merging undertakings to reduce their capacities and raise prices or whether the other competitors are able to compensate for the production reduction by the merging undertakings. In markets where competition is primarily on price, the Commission will look primarily at how readily the goods offered by the merging undertakings can be substituted. If the goods are very similar, then the merger will raise greater concerns than it would if they were more dissimilar. Moreover, the Commission will analyze factors such as market entries, purchasing power and business efficiencies.

Unfortunately, the Notice is extremely scant on explaining the assessment criteria for the review of mergers in this category. This is understandable since there is as currently very little any case law or Commission practice to draw on, which of course creates legal uncertainties. On the other hand, this lack of explanation is even more remiss with regard to mergers in this category, because legal uncertainties

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37 The so-called HHI is the sum of the squared market shares. In the example, the HHI prior to the merger would be 2250 points \((15^2 + 15^2 + 30^2 + 30^2)\). The aggregate HHI after the merger would be 2700 points \((30^2 + 30^2 + 30^2)\).
38 See Criteria for Distinguishing between Competitive and Dominant Oligopolies, *supra* note 5 (regarding different oligopoly theories).
40 *Id.* at para. 34.
are a definite danger to arise in this particular area.

In summary, it can be said that the Commission will continue to use the same review criteria such as market position, barriers to market entry, and demand in evaluating mergers. As to mergers in an oligopoly, the Commission will be able, in the future, to prohibit these on the grounds of unilateral effects. Whether the Commission can thereby prohibit mergers more easily will depend in large part on what evidentiary showing the courts will require regarding unilateral effects in oligopolies.

V. HARMONIZATION WITH U.S. LAW

A further argument for the introduction of the new test is harmonization with U.S. law. Under Section 7 of the Clayton Act, mergers can be prohibited if their effect "may be substantially to lessen competition, or to tend to create a monopoly." The U.S. Department of Justice and the Federal Trade Commission have issued joint Horizontal Merger Guidelines ("U.S. Merger Guidelines") in which they set forth their merger review criteria. These review criteria have been confirmed by case law. In these U.S. Merger Guidelines, the competition authorities distinguish between a lessening of competition through coordinated interaction and through unilateral effects. They base their review on substantially the same criteria as those used by the European Commission and by the European courts. As underscored in the introduction, the "unifying theme" of the U.S. Merger Guidelines is "that mergers should not be permitted to create or enhance market power or to facilitate its exercise." Not surprisingly, decisions on both sides of the Atlantic rarely differ.

The General Electric/Honeywell case did, however, demonstrate a few differences in the evaluation of mergers. General Electric and Honeywell were current or potential competitors in several markets. The Commission's concerns about the merger were largely based on the product line diversity and exclusion effects, inasmuch as the undertakings could combine largely complementary business sectors. The Commission feared that the strengthening of General Electric's financial power and the vertical integration of business sectors of both undertakings, as well as the combination of complementary products, would permit the merging

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43 Id. at 2.
44 Commission Decision of 03/07/2001 declaring a concentration to be incompatible with the common market and the EEA agreement, Case No. COMP/M.2220, General Electric/Honeywell, available at http://europa.eu.int/comm/competition/mergers/cases/ decisions/m2220_en.pdf.
undertakings to expel other competitors from the market. Ultimately, the merger would have detrimental effects on product quality, service and price.\(^4\) The U.S. Department of Justice, by contrast, viewed the combinability of the complementary products as an argument for clearing the merger, inasmuch as the products could then be offered to customers at lower prices.\(^5\) The U.S. Department of Justice rejected as speculative the Commission's citation of the long-term effects of being expelled from the market. The divergent evaluations of the merger in this case were likely due to the fact that they were considered at two different points in time.

The case illustrates the different attitudes of the competition authorities regarding the evaluation of business efficiencies. With the reform of the Merger Control Regulation, the Commission's attitude toward business efficiencies achieved through merger could be approaching the positive evaluation of these by U.S. competition authorities. Until now, the Commission's rulings have not shown that it can be persuaded by the efficiencies argument to grant a clearance.\(^6\) In a few rulings, the Commission has even regarded efficiencies as a negative factor, inasmuch as these increase the undertaking's lead over its competitors and therefore support the argument that they contribute to the creation or strengthening of a dominant market position.\(^7\)

Rationale Number 29 in the new Regulation No. 139/2004 now challenges the courts and the Commission to consider in their merger review efficiencies arguments by the participating undertakings.\(^8\) Now it is supposedly possible that efficiencies resulting from a merger may compensate for the effects of the merger on competition, especially the damages to the consumers, so that effective competition is not significantly impeded by the merger. In its Notice regarding the evaluation of horizontal mergers, the Commission indicated the conditions under which it will consider such efficiencies. These conditions are based on the conditions contained in the U.S. Merger Guidelines. The undertakings involved have to demonstrate that the increased efficiencies are directly beneficial to the consumer, are causally connected to the merger, are broad and will occur without major delay.\(^9\) Moreover, the Commission will consider

\(^{45}\) *Id.*

\(^{46}\) U.S. Department of Justice, *Range Effects: The United States Perspective* 23 (Oct. 12, 2001) (discussing the EC's decision regarding the GE/Honeywell acquisition).


\(^{48}\) See Case IV/M.050, AT&T/NCR, 1991 O.J. (C 016) 1, at para. 28; Case IV/M.130 Delta Air Lines/Pan Am, 1991 O.J. (C 289) 1, at para. 20.

\(^{49}\) EC Merger Regulation, *supra* note 1, at 4.

\(^{50}\) Commission Guidelines on the assessment of horizontal mergers, *supra* note 29, at para. 76.
efficiencies only in cases where adequate competitive pressure is present. If the undertakings can demonstrate the existence of these conditions, the Commission can conclude that the increased efficiencies outweigh the feared anticompetitive effects of the merger and allow the merger.

What importance the defense of increased efficiencies will have in practice cannot be predicted at this point. However, it will most likely have a rather small part to play, given the great difficulty of proving or anticipating increased efficiencies. Thus, there has yet to be a case in the U.S. where an anticompetitive merger was allowed on the basis of an efficiencies defense. Nonetheless, the undertakings should draw the Commission’s attention early on to possible increased efficiencies of the merger and then to quantify these, if possible.

During the last few years, E.U. competition law has increasingly come to resemble U.S. law. Even before the amendment of the Merger Control Regulation, the Commission and the U.S. competition authorities applied substantially the same criteria in a merger analysis.51 With this amendment to the Merger Control Regulation, now even the language of the text is similar to U.S. law. But despite this similarity of language, there can still be diverging decisions by the competition authorities in the future. This is due in part to the differing effects of mergers in the United States and the European Union. Also, a merger’s effects on competition can be evaluated differently even if the same facts and the same test language are used. Thus, in complicated merger cases, even the Commissioners of the Federal Trade Commission arrive at different views regarding the effects on competition of a merger.

VI. LEGAL CERTAINTY THROUGH RETENTION OF THE MARKET DOMINANCE TEST AS REGULATORY EXAMPLE

The purpose of identifying the creation or strengthening of a dominant market position as an example of significant impediment of effective competition is to let earlier court decisions and Commission rulings continue to serve as authority for evaluating mergers.52 The listing of market dominance as a regulatory example and the retention of the evaluation criteria in Section 1 of Article 2 of the Merger Control Regulation demonstrate that, in the future, the same standards for the evaluation of mergers will be used as what was employed in the past. It is standard legal practice to review a case in terms of the specific regulatory provision before examining the generalized one. Thus, the first element of

52 EC Merger Regulation, supra note 1, at 4.
review is whether the merger creates or strengthens a dominant market position. If this is the case, then without further examination a significant impediment to effective competition can generally be assumed. This approach offers the advantage that, for most mergers, the former market dominance test can basically still be used.

Legal uncertainty remains, however, concerning mergers which occur in a close oligopoly, but are possibly not covered by the previous collective market dominance test. For these cases, the regulatory example of the creation or strengthening of a dominant market position obviously does not provide any help. Legal certainty in this case can be obtained only through the publication of evaluation criteria. Unfortunately, the Commission’s Notice regarding the evaluation of horizontal mergers is very scant on this very category of an oligopoly without coordination. For the undertakings involved there is still legal uncertainty which should not be underestimated.

VII. CONCLUSION

The new test of the Merger Control Regulation probably does not constitute a true cultural change. The Commission will continue to base its evaluation of mergers on an analysis of the merging undertakings’ market position, the structure of the opposite side of the market, and potential competition. There is a change, however, for mergers which result in a close oligopoly in which no single competitor has an outstanding market position. In such cases, the Commission will examine the merger not only with regard to coordinated effects, but will also examine, based on the market conditions, whether the merger will lead to a price increase or a reduction in production capacity through unilateral effects. It is yet to be seen what proof the courts will require regarding the unilateral effects in oligopolies. Therefore, for this category, there is greater legal uncertainty that cannot be eliminated by identifying market dominance in Article 2 of the Merger Control Regulation as the regulatory example.