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# Substantive Appraisal of Horizontal Mergers under EEC Regulation 4064/89: An Inquiry into the Commission's First Year Decisions

*Frank M. Hellemans\**

## INTRODUCTION

On December 21, 1989, sixteen years after the first proposal of the European Commission (Commission),<sup>1</sup> the Council of Ministers of the European Communities (EC) finally adopted the long-awaited Merger Control Regulation.<sup>2</sup> The Regulation, which entered into force on September 21, 1990, brings about a considerable shift in the balance of power between the Commission and the competition authorities of the twelve member states. Sir Leon Brittan, the EC Competition Commissioner, described the Regulation as a "historic breakthrough in the creation of a single European market."<sup>3</sup>

Generally speaking, the Regulation causes three important changes. First, by transferring the responsibility to review most large European mergers to one single institution, the Commission, and by insuring iden-

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<sup>1</sup> Proposal for a Regulation of the Council on Control of Concentrations Between Undertakings, 1973 O.J. (C 92) 1.

<sup>2</sup> Council Regulation (EEC) No. 4064/89 on the Control of Concentrations Between Undertakings, 1989 O.J. (L 395) 1 [hereinafter Merger Regulation].

<sup>3</sup> Denise Claveloux, *Step Closer to Unity in Europe*, CHI. TRIB., Dec. 22, 1989, at C1.

tical standards of scrutiny, the Regulation provides a much needed "level playing field." Indeed, in a unified Europe, major cross-border concentrations<sup>4</sup> falling within the Regulation, need to be cleared on the basis of uniform and non-discriminatory EC Law, instead of being governed by the national laws of the twelve member states, particularly since these national laws are far from homogeneous.

Second, the Regulation achieves to a large extent a 'one-stop-shop' principle whereby the Commission scrutinizes "all concentrations with a Community dimension,"<sup>5</sup> but leaves the review of the remaining mergers to the national authorities.<sup>6</sup>

Finally, the adoption of the Regulation fills the major lacuna in EEC Competition Law, being the absence of specific merger control provisions. Until 1989, there was no EC counterpart to U.S. Section 7 of the Clayton Act. Indeed, in its 1966 Memorandum to the Member States on Concentration of Enterprises in the Common Market,<sup>7</sup> the Commission took the position that, unless there was an abuse of dominant position,

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<sup>4</sup> The term "concentration" is a term borrowed from the French and German and has a broader meaning than the colloquial term "merger." The term applies to full mergers, partial mergers (such as certain joint ventures) and other acquisitions of control; see Article 3 of the Merger Regulation. Also, the term should not be confused with the meaning it has in American law, where it is used to reflect the market structure: a highly concentrated market is one where a small number of firms account for a large share of the market. In this paper, 'merger' will refer to concentrations within the meaning of the Regulation unless indicated otherwise.

<sup>5</sup> See Articles 1, 3 and 5 of the Regulation. About the scope of the Regulation, see generally CHRISTOPHER JONES, *The Scope of Application of the Merger Regulation*, in INTERNATIONAL MERGERS AND JOINT VENTURES 385 (Barry E. Hawk ed., 1990); Barry E. Hawk, *The EEC Merger Regulation: The First Step Toward One-Stop Merger Control*, 59 ANTITRUST L.J. 195 (1990); Gordon B. Dunn, *EC Merger Control and 1992: Can the New Regulation Meet the Challenges of the Common Market?*, 23 N.Y.U. J. INT'L L. & POL. 115 (1990); PIERRE BOS ET AL., CONCENTRATION CONTROL IN THE EUROPEAN ECONOMIC COMMUNITY 124-202 (1992); CHRISTOPHER JONES & ENRIQUE GONZALEZ-DIAZ, THE EEC MERGER REGULATION 1-78; and LENNART RITTER ET AL., EEC COMPETITION LAW, A PRACTITIONER'S GUIDE 342-57 (1991) [hereinafter EEC COMPETITION LAW]. The Regulation foresees that the turnover thresholds will be reviewed before the end of 1993 (Article 1(3)). For a long time, a reduction of the 'combined worldwide turnover' threshold from ECU 5 billion to ECU 2 billion and of the ECU 250 million threshold to ECU 100 million seemed likely. Very recently, however, France, Germany & the UK have joined forces to oppose any expansion of the Commission's power to control large mergers which makes the lowering of the thresholds doubtful. FINANCIAL TIMES, Mar. 1, 1993 at 1. In any case for these reductions, only a 'qualified' majority of the Council of Ministers will be required, not a unanimity as for the adoption of the Regulation itself.

<sup>6</sup> About the 'one-stop-shop' approach, see generally Jones, *supra* note 5, at 402; Martin Heidenhain, *Control of Concentrations Without Community Dimension According to Article 22(2) to (5) Council Regulation 4064/89*, 1990 FORDHAM CORP. L. INST. 413 (Barry E. Hawk ed., 1991); Hawk, *supra* note 5; EEC COMPETITION LAW, *supra* note 5, at 357-60.

<sup>7</sup> EEC Commission Memorandum to the Member States on Concentration of Enterprises in the Common Market, Dec. 1, 1965, CCH Comm. Mkt. Rep. No. 26, pt. 1 (Mar. 17, 1966) (separate print).

the antitrust provisions of the Treaty of Rome did not apply to mergers.<sup>8</sup> It is true that the Commission later changed its attitude towards mergers and that both the Commission and the Court of Justice have applied Articles 85 and 86 of the EC Treaty (these Articles can be seen as the counterparts to Section 1 and 2 of the Sherman Act) to mergers and acquisitions,<sup>9</sup> but both Articles present major inadequacies as merger control tools.<sup>10</sup>

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<sup>8</sup> According to the Commission, Article 85 could only reach cartel-type agreements between independent undertakings, but did not apply to agreements "whose purpose is the acquisition of total or partial ownership of undertakings." As to Article 86, the Commission provided that it could be used as a check on mergers in the (very rare) situation where the concentration results in an unlawful abuse of dominant position: "[A] concentration of enterprises which has the effect of monopolizing a market should be treated as an improper exploitation of a dominant position within the meaning of Article 86, except where special circumstances are present." See Memorandum to the Member States on Concentration of Enterprises in the Common Market, *supra* note 7; see also James A. Rahl, *The Nature and Extent of Conflict between American Antitrust Law and Laws in the Common Market*, in COMMON MARKET AND AMERICAN ANTITRUST 148, 171-72 (James A. Rahl ed., 1970).

<sup>9</sup> In 1972, the Commission first attempted to apply Article 86 to a merger in the Continental Can case, which was decided by the Court of Justice in 1973. Continental Can, ECJ Feb. 21, 1973, 1973 ECR 215, 1973-1 CMLR 199. The Court upheld the Commission's view that Article 86 (prohibiting abuse of dominant position) also applies to 'structural' abuses of a dominant position by merger or takeover: "Abuse may therefore occur if an undertaking in a dominant position strengthens such position in such a way that the degree of dominance reached substantially fetters competition, i.e., that only undertakings remain in the market whose behavior depends on the dominant one." Continental Can, ECJ Feb. 21, 1973, 1973 ECR 215, 245, 1973-1 CMLR 199, 235 (para. 26).

In 1987, the Court in Philip Morris, ECJ Nov. 17, 1987, 1987 ECR 4487, 1988-4 CMLR 24, held for the first time that Article 85 may be used to prohibit the agreement between two competitors under which one acquires a minority shareholding position in the other:

Although the acquisition by one company of an equity interest in a competitor does not in itself constitute conduct restricting competition, such an acquisition may nevertheless serve as an instrument for influencing the commercial conduct of the companies in question so as to restrict or distort competition on the market on which they carry on business.

That will be true in particular where, by the acquisition of a shareholding or through subsidiary clauses in the agreement, the investing company obtains legal or de facto control of the commercial conduct of the other company or where the agreement provides for commercial cooperation between the companies or creates a structure likely to be used for such cooperation.

Philip Morris / Rothmans, ECJ Nov. 17, 1987, 1987 ECR 4487, 4577-79, 1988-4 CMLR 24, 59-60 (paras. 37-38).

For more examples of applications of Articles 85 and 86 to mergers, see EEC COMPETITION LAW, *supra* note 5, at 332-39; Barry E. Hawk, *Merger Regulation in the EEC*, 660 PRAC. L. INST. 15 (1989). PIERRE BOS ET AL., *supra* note 5, at 69-115; CHRISTOPHER JONES & ENRIQUE GONZALEZ-DIAZ, *supra* note 5, at 79-84. See also the yearly *Reports on Competition Policy*, published by the Commission.

<sup>10</sup> Article 86, for example, cannot be applied to the creation of a dominant position (a pre-existing dominant position is required) and the main obstacle in applying Article 85 to mergers is the prerequisite of an agreement or concerted practice. Cf. recital 6 of the Regulation. For a discussion of the importance of Articles 85 and 86 after the adoption of the Regulation, see Jacques H.J. Bourgeois & Bernd Langeheine, *Jurisdictional Issues: EEC Merger Regulation. Member State Laws and Articles 85-86*, 1989 FORDHAM CORP. L. INST. 583 (Barry E. Hawk ed., 1990); EEC COMPETITION LAW, *supra* note 5, at 360-62, 395-435. PIERRE BOS ET AL., *supra* note 5, at 391-401; CHRISTOPHER JONES & ENRIQUE GONZALEZ-DIAZ, *supra* note 5, at 84-87.

It is not the goal of this paper to examine the historical background of the Regulation or to give a full overview of the cases where the Commission has applied Articles 85 and 86 to mergers and acquisitions. Nor do we envisage a complete overview of the whole Merger Regulation. Others have done this before<sup>11</sup> and we will not attempt to improve upon them.

Rather, our purpose is to examine what criteria the Regulation prescribes for the substantive appraisal of mergers. We will not only scrutinize Article 2 of the Regulation and the different policies behind it, but we will also inquire into the Commission's decisions in order to find out how the Commission has applied the Regulation's substantive criteria to 'real live' mergers and acquisitions. Broadly speaking, this involves questions of product and geographic market definition, of calculating market shares and interpreting them and, finally, of basic goals of mergers control policy.

We will put the Commission's approach to these questions of substantive appraisal of mergers in a broader context by comparing it to the very rich American experiences in this field. In particular, we will focus on the 1984 Department of Justice (DOJ) Merger Guidelines,<sup>12</sup> while referring, in footnotes of the main text, to the changes brought about by the new 1992 Horizontal Merger Guidelines.<sup>13</sup> These Guidelines are used by the DOJ to assist in determining whether or not it will challenge a merger or acquisition under Section 7 of the Clayton Act and thus they reflect the general attitude of the DOJ towards mergers. But their impact

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<sup>11</sup> See Hawk, *supra* notes 5 and 9; Alec Burnside and Carl Meyntjens, *The EEC Merger Regulation and its Impact on Non-EEC Business*, 1990 B.Y.U. L. REV. 1373; EEC COMPETITION LAW, *supra* note 5, at 332-35; Dunn, *supra* note 5; Pierre Raoul-Duval & Gide Layrette Nouel, *The EEC Merger Control Regulation*, C536 ALI-ABA 455 (1990). PIERRE BOS ET AL., *supra* note 5 CHRISTOPHER JONES & ENRIQUE GONZALEZ-DIAZ, *supra* note 5.

<sup>12</sup> Merger Guidelines, 49 Fed. Reg. 26,823 (1984) [hereinafter 1984 Merger Guidelines].

<sup>13</sup> On April 7, 1992, the U.S. Department of Justice and the Federal Trade Commission jointly issued new Horizontal Merger Guidelines. 1992 Horizontal Merger Guidelines, 5 Trade Reg. Rep. (CCH) ¶ 13,104 (April 7, 1992) [hereinafter 1992 Merger Guidelines]. These new 1992 Merger Guidelines revise the Department of Justice's 1984 Guidelines as well as the Federal Trade Commission's 1982 Statement Concerning Horizontal Mergers. These revisions are, however, confined to horizontal mergers. Neither agency has modified its policy with respect to non-horizontal mergers. Since the 1992 Guidelines are clearly based on the 1984 Guidelines, we prefer to refer to the 1984 Guidelines in the main text, while indicating the modifications in footnotes. This technique offers the additional advantage of highlighting aspects of the 1984 Guidelines that have been substantially changed. Indeed, where no or only stylistic modifications have been made, we won't refer to the 1992 Guidelines. Consequently, one may assume that, with regard to those factors where no reference to the new Guidelines is made, no differences in content exist between the 1984 and the 1992 Merger Guidelines.

goes much further.<sup>14</sup> Indeed, private challenges of mergers are relatively rare.<sup>15</sup> That is why a firm, planning a merger, presumably will drop those plans when the government is likely to challenge this merger, but will go forward with it in the opposite case. Also, the Guidelines have a significant influence outside the DOJ enforcement context. The Federal Trade Commission stated on the same day that the 1982 version of the Guidelines<sup>16</sup> was issued that it would give "considerable weight" to the Guidelines in the "evaluation of horizontal mergers and in the development of the Commission's overall approach to horizontal mergers."<sup>17</sup> Finally, even if the Guidelines do not bind courts, litigants or corporate counselors, they are likely to refer to them as a secondary authority in their opinions.<sup>18</sup>

Article 2 of the Regulation defines the whole substantive appraisal of concentrations 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."<sup>19</sup>

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<sup>14</sup> PHILLIP AREEDA & H. HOVENKAMP, *ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION* 504 (Supp. 1990).

<sup>15</sup> Three main reasons explain the limited role of private parties in merger enforcement. First, a merger is usually challenged by the DOJ before any economic damages arise, in other words, before the new firm, resulting from the merger has had the opportunity to exercise the market power allegedly obtained through the merger. Second, the anti-competitive effects that mergers can bring about, are often very dispersed. Consequently, private parties harmed by the merger might not always recognize this harm or, if they do, might be prevented from suing the newly merged firm by free-rider problems. Third, would-be plaintiffs are motivated to wait until the DOJ has brought a suit before suing the merged firm themselves. Indeed, the cost of a private Section 7 suit will be significantly less after a DOJ action, mainly because, if the DOJ action is successful, parties might be permitted by the doctrine of collateral estoppel to drop the proof of some elements of their claim. Also, the costs of discovery may be significantly lower, as plaintiffs can refer to the record produced by the prior DOJ action. Gene C. Schaerr, Note, *The Cellophane Fallacy and the Justice Department's Guidelines for Horizontal Mergers*, 94 YALE L.J. 670, 671 n.8 (1985).

<sup>16</sup> Merger Guidelines, 47 Fed. Reg. 28,493 (1982).

<sup>17</sup> Fed. Trade Comm'n, Statement Concerning Horizontal Mergers, reprinted in 42 ANTITRUST & TRADE REG. REP. (BNA) No. 1069, Special Supp., at S-12 (June 17, 1982). As we have indicated above, the new 1992 Horizontal Merger Guidelines revise the 1982 Statement Concerning Horizontal Mergers. It is noteworthy that for the first time in their existence both federal agencies sharing antitrust enforcement jurisdiction have issued joint guidelines. See generally 1992 Merger Guidelines, *supra* note 13, at 20,569.

<sup>18</sup> See generally Schaerr, *supra* note 15, at 672 n.12.

<sup>19</sup> Article 2(3) of the Regulation. Article 2(2) uses the same wording but formulates the test in a negative way: "A concentration which does not create or strengthen 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 compatible with the common market." (emphasis added). This juxtaposition clearly shows that the Commission has to take a decision in one way or the other and that an "in between" solution is excluded. Article 8(2) of the Regulation foresees, however, the possibility for the Commission to modify the proposed merger so that it takes into account the Commission's objections and thus can be declared compatible with the common market. In that case, the Commis-

This test asks for an analysis in three steps. The first, but often most difficult, step consists in defining the markets concerned, i.e. the 'relevant markets,' both in terms of products and geography. This process will be the subject of the first chapter of this paper. It focuses on the criteria used by the Commission to define the relevant markets.

After determining the market shares of the firms concerned, the second step of the analysis is to predict the effect of the proposed merger on these markets. In other words, will the merger give rise to or strengthen a dominant position? This question will be examined in the second chapter. We will also inquire into the question whether or not the Commission relies on a theory of collective dominance to expand the application of the Regulation to narrow oligopolies.

The third and final step is only taken when the question whether a dominant position is created or strengthened is answered positively. In that case, the Commission will have to determine whether that dominant position would significantly impede effective competition in all or a substantial part of the common market. When this final question also receives a positive answer, the Commission will have to declare the merger 'incompatible with the common market.' Until now, the Commission has only dealt once with this last question, namely in the *Aérospatiale-Alenia / de Havilland* decision.<sup>20</sup> It goes without saying that we will focus mainly on this decision in the third and last chapter, without leaving aside, however, the further question of the utility of this extra requirement.

As indicated above, we will, in each chapter, compare the Commission's approach with the approach taken under the 1984 and 1992 Guidelines.<sup>21</sup> However, it is not the goal of this comparison to give a complete and detailed overview of present U.S. merger law. Rather, we will use U.S. law only to enlighten our thoughts about current E.C.

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sion will attach conditions and obligations to its decisions in order to ensure "that the undertakings concerned comply with the commitments they have entered into *vis-à-vis* the Commission." Article 8(2), second subparagraph, of the Regulation. On different occasions, the Commission has used this provision to attach obligations to its approval. See *Alcatel / Teletra*, D. Comm., April 12, 1991, 1991 O.J. (L 122) 48; *Magneti Marelli / CEAc*, D. Comm., May 29, 1991, 1991 O.J. (L 222) 38; *Varta / Bosch*, D. Comm., July 31, 1991, 1991 O.J. (L 320) 26. *Accor / Wagons Lits*, D. Comm., April 28, 1992, 1992 O.J. (L 204) 12; *Nestle / Perrier*, D. Comm., July 22, 1992, 1992 O.J. (L 356) 31; *DuPont / ICI*, D. Comm., Sept. 30, 1992, 1993 O.J. (L 7) 23-24. This practice of attaching conditions to approval decisions was already established by the Commission before the adoption of the Regulation, when Articles 85 and 86 were used as merger control tools. See EEC COMPETITION LAW, *supra* note 5, at 386-87 n. 215-23.

<sup>20</sup> *Aérospatiale-Alenia / de Havilland*, D. Comm., Oct. 2, 1991, 1991 O.J. (L 334) 42.

<sup>21</sup> The changes brought about by the new 1992 Horizontal Merger Guidelines will be explained in footnotes of the main text. See *supra* note 13.

merger policy. At the same time, we will point to similarities and differences between the merger policies in the two continents, and examine to what extent the latter can be explained by distinct underlying legal standards.

In the conclusion of this paper, we will indicate major weaknesses in the Commission's approach and the main issues which remain unresolved. With regard to each of them, we will make some suggestions in order to cure the former and resolve the latter.

## CHAPTER 1: MARKET DEFINITION IN MERGER CASES

### Introduction

Before starting to examine how the process of market definition actually works, it seems appropriate to make three preliminary remarks.

First, it is important not to lose sight of the fact that market definition is not a purpose in itself, but is only a means to an end.<sup>22</sup> The final objective is to assess whether or not the proposed merger will 'create or strengthen a dominant position'<sup>23</sup> or, to put it in U.S. terms, whether the effect of the acquisition 'may be substantially to lessen competition or tend to create a monopoly.'<sup>24</sup>

The basic attitude taken under Article 2 of the Regulation or under Section 7 of the Clayton Act thus differs from the one taken when applying Article 86 of the Treaty of Rome or Section 2 of the Sherman Act. In the latter cases, we examine the present and the past in order to find out whether an undertaking actually abuses its dominant position<sup>25</sup> or whether a person monopolizes or attempts to monopolize.<sup>26</sup> In the former, we are trying to predict the future. It is clear that these predictions about the future will be less precise and more speculative than the infer-

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<sup>22</sup> Phillip Areeda, *Market Definition and Horizontal Restraints*, 52 ANTITRUST L.J. 553, 553 (1983).

<sup>23</sup> Cf. Article 2(3) of the Merger Regulation.

<sup>24</sup> Cf. Section 7 of the Clayton Act.

<sup>25</sup> Cf. Article 86 of the Treaty of Rome. The full text of Article 86 goes as follows:

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States.

Such abuse may, in particular, consist in:

- (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
- (b) limiting production, markets or technical development to the prejudice of consumers;
- (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contract.

<sup>26</sup> Cf. Section 2 of the Sherman Act.



ences about the past.<sup>27</sup> This will also influence the way in which relevant markets are defined. Generally speaking, markets will be defined in a somewhat broader way in merger cases than they are under Article 86 or under Section 2 of the Sherman Act.

There is still another difference between both groups of cases, that leads to slightly broader market definitions. Article 86 does not seek to prohibit a dominant position in itself, but only the abuse of a dominant position. In a similar way, Section 2 does not merely demand the possession of monopoly power, but also requires "the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of superior product, business acumen, or historic accident."<sup>28</sup> In both cases, there is an element of willful conduct: they are behavior oriented. Article 2 of the Regulation and Section 7 of the Clayton Act, on the other hand, are structure oriented. They merely tend to predict the effect of the merger on the structure of the market, in order to prevent the creation or reinforcement of a dominant position<sup>29</sup> or to avoid a substantial lessening of competition or creation of a monopoly.<sup>30</sup>

A second remark worth making, concerns the distinction between market power and dominant position. Market power is in the first place an economic concept: it is defined by economists as the power to raise prices above (and to restrict output below) competitive levels, without a costly loss of sales.<sup>31</sup> But this economic concept does not answer the critical, legal question where to draw the line between acceptable and suspect market power.<sup>32</sup> In the E.C., this question is answered by the concept of dominant position, which is in the first place a legal construction, based on policy considerations, indicating what quantum of market power can be seen as an appropriate subject of concern. While market

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<sup>27</sup> PHILLIP AREEDA & LOUIS KAPLOW, *ANTITRUST ANALYSIS: PROBLEMS, TEXT, CASES* 815 (4th ed. 1988).

<sup>28</sup> *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966).

<sup>29</sup> This is the test foreseen in Article 2 of the Merger Regulation.

<sup>30</sup> This is the test foreseen in Section 7 of the Clayton Act. The reader should not interpret this juxtaposition of Article 85 of the Rome Treaty and Section 2 of the Sherman Act, on the one hand, and Article 2 of the Merger Regulation and Section 7 of the Clayton Act, on the other hand, as implying that the tests foreseen within each sub-group are fully similar.

As we will show in the second chapter, the 'dominant position test' foreseen in the Merger Regulation fundamentally differs from the so-called 'incipiency-test' of Section 7 of the Clayton Act.

<sup>31</sup> See, e.g., F.M. SCHERER, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 11 (2d ed. 1980); ERNEST GELLHORN, *ANTITRUST LAW AND ECONOMICS IN A NUTSHELL* 86 (2d ed. 1981); AREEDA & KAPLOW, *supra* note 27, at 564; WILLIAM G. SHEPHERD, *MARKET POWER & ECONOMIC WELFARE* 3, 33 (1970); CARL KAYSER & DONALD F. TURNER, *ANTITRUST POLICY* 75 (1959).

<sup>32</sup> BARRY E. HAWK, *UNITED STATES, COMMON MARKET AND INTERNATIONAL ANTITRUST: A COMPARATIVE GUIDE* 788 (2d ed. Supp. 1990).

power is thus clearly a question of degree, dominant position is a more absolute concept. Either a firm has a dominant position or it doesn't: there is no in-between solution.

Finally, one can wonder why courts tend to first define the relevant markets and the market shares, on the basis of which they *infer* market power.<sup>33</sup> Indeed, why don't we try to measure market power directly by examining whether and how much the price charged by a firm is higher than its marginal cost? We don't do this because it is too complex to gather and appraise the relevant economic data. Where it is still possible to find out the price charged for a product, measuring its marginal cost is much more difficult, if not impossible.<sup>34</sup>

Another possible solution is to look at the profits of the firms concerned and to find out whether they exceed the normal return in a competitive equilibrium.<sup>35</sup> This alternative poses, however, similar practical difficulties: the economic concepts of costs and profits are not directly reflected in accounting books. But even if we could find out the costs and profits of a firm, this approach might still be misleading. Reasonable profits, for example, might be caused by excessive costs that, in turn, can be explained by inefficient management or inefficient production due to the absence of competitive pressures. Excess profits, on the other hand, do not always imply market power either. They could, for example, be caused by short-run fluctuations or by lawful advantages, such as patents or efficiencies.

These practical problems explain why courts have given only a limited importance to those performance tests.<sup>36</sup> Both in the U.S. and in the Common Market, courts and antitrust authorities have consistently given preference to the conventional two-step approach in behavior-oriented as well as in structure-oriented cases. The first step of this approach consists of defining the relevant market, both in terms of product and geography. On the basis of these market definitions, it is possible to calculate market shares that will then serve as tools to assess whether or not the merged firms will be able to exercise substantial market power.

This first chapter will contain two sections. The first section will focus on the definition of the product market. After an initial economic analysis of the product market, we will examine the criteria used by the Commission to define the product market and compare this approach to

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<sup>33</sup> Cf. AREEDA & KAPLOW, *supra* note 27, at 567-68; HAWK, *supra* note 32, at 790-91; GELLHORN, *supra* note 33, at 88-89.

<sup>34</sup> RICHARD A. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* 189 (1976); SCHERER, *supra* note 31, at 269.

<sup>35</sup> AREEDA & KAPLOW, *supra* note 27, at 567-68.

<sup>36</sup> *Id.*

the one taken in U.S. Law. The second section, which will focus on geographic market definition, will reflect the same basic structure.

## Section 1: Defining the Relevant Product Market

### 1. *Economic Analysis*

Basically, a firm's ability to increase the price of its product and, thus, its market power is constrained in two ways.<sup>37</sup> On the one hand, buyers might react to a price increase by turning to a substitute product. This is what is called demand substitutability, which is measured by the cross-elasticity of demand: a high cross-elasticity of demand means that a small increase in the price of one product will cause many buyers to shift to another product.

But even if the demand for a product is inelastic, even if no (or very few) buyers react to a price increase by shifting to another product, a firm might still not have market power. Other producers might enter the market or might expand their production. This is called supply substitutability, which is measured by the elasticity of supply (indicating to what extent the firms in the market can increase their production) and by the cross-elasticity of supply (indicating the ability of firms that are actually not producing the product in question to enter this market).

The process of defining the relevant product market in merger cases consists of including in the relevant market only those products, and those suppliers, who can be expected to restrain significantly the market power of the new firm resulting from the merger.<sup>38</sup> In economic terms, this means that we will only include a product in the relevant market if there exists a high cross-elasticity of demand between this product and the one manufactured by the firms proposing a merger. On the other hand, a supplier will only be taken into account, when it produces the same product as the one produced by the merging firms or, if it produces a different product, when there exists a high cross-elasticity of supply between the merging firms and the suppliers in question.

Demand substitutability and supply substitutability have three characteristics in common. First, both are "critical questions of degree."<sup>39</sup> Coke and Pepsi, for example, will be seen by most consumers as close substitutes and can thus be held to be in the same market. But what about the other brands of carbonated drinks? Or the non-carbonated juices? Even though you can still argue that the former should be in-

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<sup>37</sup> HAWK, *supra* note 32, at 750.

<sup>38</sup> AREEDA & KAPLOW, *supra* note 27, at 572.

<sup>39</sup> HAWK, *supra* note 32, at 749.

cluded in the same market as Coke and Pepsi, because an increase in price of those products will cause many buyers to shift to other brands of carbonated drinks, it is more difficult to take the same position with regard to non-carbonated juices. Nevertheless, non-carbonated juices might still influence to a certain extent the market power of Coke and Pepsi. The point is that the all-or-nothing choices that the market definition process brings about, can make the resulting market shares very misleading. It is therefore absolutely crucial to interpret these market shares in their correct context.

A similar example and a similar remark can be made with regard to supply substitutability. Suppose, for instance, you have two firms manufacturing bikes, one specializing in mountain bikes, the other one in racing bikes, but both able to switch without considerable cost or time to the type of bike produced by the other. If the firm producing mountain bikes decreases its output and increases its prices, then the firm specializing in racing bikes, will probably enter the mountain bike market because it will be attracted by supra-competitive profits. You could thus argue that both firms should be held to be in the same market. But if you include the complete output of the racing bike firm, it is clear that you will overstate its ability to limit the market power of the mountain bike firm. Indeed, the more mountain bikes the racing bike firm produces, the faster the mountain bike price will return to its competitive level and the less attractive it becomes to shift part of the production to this market. On the other hand, unless the racing bike firm has excess capacity, the prices of racing bikes will increase as output goes down, because a part of the capacity is now used to produce mountain bikes.<sup>40</sup> Again it is crucial to interpret market shares in their correct context and thus to be aware that, if you include the complete output of the racing bike firm in the relevant market, you understate to a certain degree the mountain bike firm's power to influence market prices.

A second characteristic that demand and supply substitutability have in common, is that they are both, to a certain extent, a function of time.<sup>41</sup> Indeed, when substitute products have different physical characteristics, the cross-elasticity of demand can vary substantially over time. Suppose the central heating facility of an office building can only burn oil, and not gas. Despite the increase in price of oil, the building managers may calculate that it is more economical not to change the heating installation (so that they can burn gas instead of oil), but to wait until the

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<sup>40</sup> Cf. HAWK, *supra* note 32, at 753.

<sup>41</sup> PHILLIP AREEDA & DONALD F. TURNER, 2 ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION 348-50 (1978); HAWK, *supra* note 32, at 751.

existing installation is 'worn out.' This example shows that there might be cases where the demand shifts are so gradual that their full impact on prices will only be reflected over several years. In the meantime, the producers of oil will see their market power gradually declining. It is important to take this decline into account when assessing a merger between two oil producing companies. When the relevant product market is defined as the oil market alone, the new firm's market power over time will be overstated. If, on the other hand, both oil and gas producers are included in the relevant market, the market power of the merging firm will be overstated, especially at the beginning of the time period.

Time will also have an important influence on the supply side. In the short run, supply substitutability will be determined solely by the capacity of the firms who are actually in the relevant product market, and by the ability of firms who are not yet in that market to readily shift their production towards it. In the longer run, supply substitutability can also take into account the ability and willingness of existing and new firms to build new capacity or to adapt substantially the existing one. It is clear, however, that it will be very difficult, if not impossible, to determine the amount of new capacity that will be built in the long run. This explains the restricted influence of long-term supply elasticity on market definition. Nevertheless, this long-term elasticity should be taken into account during the second step of the analysis, when we interpret the market shares obtained through market definition.

A third common characteristic of demand and supply substitutability is the extreme difficulty of measuring them directly.<sup>42</sup> This explains why both in the Common Market and in the United States, courts and antitrust authorities have mainly relied upon factors and criteria that indicate demand and supply substitutability, without trying to measure them directly.

What are these factors and criteria? How much weight is given to each of them? Are they the same in the Common Market and in the United States? And, if not, what are the major differences? These are some of the questions we will now address.

## *2. Product Market Definition Under the New Merger Regulation*

Section 5 of the EC merger notification form 'CO'<sup>43</sup> defines the relevant product market as follows: "A relevant product market comprises all those products and/or services which are regarded as interchangeable

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<sup>42</sup> HAWK, *supra* note 32, at 753, 790-91; GELLHORN, *supra* note 31, at 91; POSNER, *supra* note 34, at 48, 57.

<sup>43</sup> Commission Regulation 2367/90, 1990 O.J. (L 219) 5, at 15.

or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use."<sup>44</sup> What stands out in this definition is that it is mainly based on the view from the demand-side. When consumers experience two products as being interchangeable or substitutable they should be held to be in the same market. Nevertheless, the Commission has not limited itself to this fairly strict test in assessing the relevant product markets. Other criteria, such as the structure of demand, marketing policies, conditions of competition and, at least in some cases, supply substitutability have also been taken into account.

It is difficult to extrapolate from the Commission's decisions a clear, structured approach towards market definition. Rather, the Commission's approach has been pragmatic. This means that if the Commission is confronted with a merger that leaves little or no doubt as to its compatibility with the Common Market, it will content itself with a concise and rudimentary analysis. On the other hand, the bigger the danger that the examined merger might create or strengthen a dominant position as a result of which effective competition would be significantly impeded, the more detailed and complex its analysis will be. As will be shown in the following chapters, this observation is not limited to product market definition, but can be expanded to every step of the substantive appraisal of mergers.

With regard to market definition, it is possible to divide the decisions of the Commission that we have scrutinized, into three groups. A first group contains those decisions where the Commission did not find it necessary to arrive at a specific market definition, because the merger does not raise any serious doubts.

In the AG / Amev case,<sup>45</sup> the Commission had to review a proposed merger between the Belgian and Dutch based insurance groups, AG and Amev.<sup>46</sup> In defining the relevant service market, the Commission first ascertained that both Amev and AG offered a wide range of types of insurance covering all kinds of risks. More precisely, the parties distinguished up to 19 different types of insurance and suggested that there would be as many relevant service markets as there are insurance types

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<sup>44</sup> This corresponds to the Commission's standard definition of substitute products used in block exemptions. See, e.g., Article 3(1)(a) of Regulation 417/85; Article 3(3) of Regulation 418/85; Article 3(a) of Regulations 1983/83 and 1984/83.

<sup>45</sup> AG / Amev, D. Comm., Nov. 21, 1990, 1990 O.J. (C 304) 27.

<sup>46</sup> In particular, both companies proposed to concentrate all their interests and activities into two subholding companies in which they would each receive 50% of the shares and have equal board representation. The parents remained merely as independent holding companies. The Commission considered this transaction as a merger-type joint venture falling within the meaning of Article 3(1)(b) of the Merger Regulation.

for different kinds of risks. The Commission stated that "it can be left open whether this suggestion is correct, because even on this narrow market definition the merger does not raise serious doubts."<sup>47</sup> Even if this specific concentration presented only a few questions as to its compatibility with the Common Market,<sup>48</sup> we regret that the Commission did not use this case to elucidate its views towards the insurance market. Is life insurance in a distinct market from fire or medical care insurance? Is the nature of the risk, covered by the insurance, not a determining factor to put the above-mentioned insurances in different service markets? Maybe the type of consumers (corporations versus individuals) is a relevant factor? These are all pertinent questions that the Commission does not go into, thus (willfully?) missing the chance to give greater future weight to its decision.

A similar remark can be made with regard to the Dräger / IBM / HMP case.<sup>49</sup> Dräger, IBM and HMP proposed to set up a new joint venture, named 'Hospitronics.' This joint venture would provide computerized intensive health care and patient data management solutions for both public and private hospitals. After mentioning the different functions that these solutions offered by Hospitronics would perform, the Commission went on to distinguish them from software that is used in other areas of medical activity and that does not address the specific needs of intensive care units. Reacting to the parties' suggestion that their product should be further distinguished from other patient management solutions developed for intensive care units, the Commission held that this "can be left open and need not to be decided for the purpose of this decision."<sup>50</sup>

A second group of cases, more important both in quantity and in quality, concerns decisions that give a concrete idea of how the above

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<sup>47</sup> AG /Amev, *supra* note 45, at 10. In later cases involving insurance companies, the Commission seemed to take the view that there exist as many product markets as there are insurances for different kinds of risk. See UAP / Transatlantic / San Life, D. Comm. Nov. 11, 1991, 1991 O.J. (C 296) 12; Schweizer Rück / Elvia, D. Comm. Jan 14, 1992, 1992 O.J. (C 27) 14; Fortis / LaCaixa, D. Comm. Nov. 5, 1992, 1992 O.J. (C 297) 4.

<sup>48</sup> The operation was mainly a conglomerate merger. Both parties operated on the same service market, but primarily in distinct, although neighboring, geographic markets. Consequently, the companies were only minor competitors on each other's markets and the merger only very slightly increased their combined market share, which made the creation or strengthening of a dominant position unlikely. Moreover, high entry barriers made it improbable that the parties would have been able to increase their market shares in each other's market without the merger.

<sup>49</sup> Dräger / IBM / HMP, D. Comm., June 28, 1991, 1991 O.J. (C 236) 6.

<sup>50</sup> *Id.* at 15. For more examples of rather crude product market definitions, see ICI / Tioxide, D. Comm., Nov. 28, 1990, 1990 O.J. (C 304) 27; CONAGRA / IDEA, D. Comm., May 30, 1991, 1991 O.J. (C 175) 18; Ingersoll-Rand / Dresser, D. Comm. Dec. 18, 1991, 1992 O.J. (C 086) 15.

definition of relevant product market is applied by the Commission and how this definition is complemented by several other criteria.

In the case Renault / Volvo,<sup>51</sup> the first concentration of which Commission was notified under the new Merger Regulation,<sup>52</sup> the operations proposed by the parties<sup>53</sup> affected the markets of trucks, buses and coaches. Addressing the truck market, the Commission stated that this market was "commonly subdivided into three sub-markets":<sup>54</sup> a segment below 5 tons, another one between 5 and 16 tons (the intermediary range) and, finally, a segment above 16 tons (the upper range). Only the last two segments were affected by the merger, because Renault and Volvo only manufactured and retailed trucks in those categories. The Commission rejected the parties' contention that the market for trucks above 5 tons should be seen as a single market. Therefore the Commission based its decision on three criteria. First, that the *technical requirements* of the upper range trucks differ significantly from those of the intermediate range. This results in other key components such as the type of engine, the number of axles, the trailer, etc. This distinct configuration can be declared by a different *use* of both kinds of vehicles: upper range trucks are mainly used "in long haul, construction and long distance traffic."<sup>55</sup>

Finally, these technical aspects influence the *marketing* of each range of trucks which is directed to two *distinct groups of costumers*. The Commission distinguished the bus and coach markets from each other, mainly using the same criteria as those mentioned above: different technical requirements, different use (public versus tourist transport) and distinct costumers.<sup>56</sup> It will be noted that in none of these two analyses did the Commission make any reference to supply substitutability. Is it then a coincidence that both Renault and Volvo are present in each of these 'distinct' markets, because almost all of their competitors that are present

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<sup>51</sup> Renault / Volvo, D. Comm., Nov. 6, 1990, 1990 O.J. (C 281) 2.

<sup>52</sup> Renault / Volvo, 1990 O.J. (C 254) 3. The Commission was notified of the proposed concentration on October 4, 1990, 14 days after the Regulation entered into force.

<sup>53</sup> Renault and Volvo wanted to exchange shareholdings of 25% in each other's car business and of 45% in each other's truck and bus business. Moreover, they agreed to set up three joint committees, namely a general policy committee, a joint car committee and, finally, a joint truck and bus committee.

The Commission held that the cooperation on cars did not amount to a concentration, because the 25% cross-shareholding did not create a sufficiently strong interest between the parties to cause them to fully integrate their car activities. The operations with regard to trucks and buses, however, were held to amount to a merger.

<sup>54</sup> Renault / Volvo, *supra* note 51, at 9.

<sup>55</sup> *Id.* at 10.

<sup>56</sup> The same distinction between the bus and coach market, based on identical criteria, was made in the RVI / VBC / Heuliez case, D. Comm., June 3, 1991, 1991 O.J. (C 149) 15.



in one market also compete in the others? The pertinent questions that the Commission failed to ask, are whether the distinct technical characteristics of different ranges of trucks and of buses and coaches also require distinct skills to design them, distinct machines and differently skilled laborers to manufacture them and other techniques to market them, etc. If the answers to these questions are positive, then it will be difficult and costly for a firm to shift its production from one product to another and the products can be held to be in distinct markets. If, on the contrary, the questions would receive a negative answer, then cross-elasticity of supply would be high and the products in question should be held to be in the same market. Although we are well aware that in many cases, the cross-elasticity of supply will be low, we nevertheless deplore that the Commission seldom gets involved in these important issues. All the more because in 1973, in the *Continental Can* case,<sup>57</sup> the Court of Justice reversed the Commission's decision because the Commission had not sufficiently set forth the facts and rationale on which it founded its definition of the relevant product market. In particular, the Court emphasized the Commission's failure to consider adequately the cross-elasticity of supply: ". . . a dominant position on the market for light metal containers for meat and fish cannot be decisive, as long as it has not been proved that competitors from other sectors of the market for light metal containers are not in a position to enter this market, by a simple adaptation, with sufficient strength to create a serious counterweight."

In the case *Promodes / Dirsra*,<sup>58</sup> the Commission distinguished three markets in the food retailing sector, namely small specialists shops (mostly run by craftsmen, such as bakers and butchers), small self-service stores and supermarkets with a floor space of under 400 m<sup>2</sup> and, finally, large supermarkets and hypermarkets with over 400 m<sup>2</sup> floor space. To arrive at this distinction, the Commission referred to the criteria of the above-mentioned definition of relevant market. First, the three distinct markets corresponded to different *product characteristics* (the larger the store, the wider the range of products that are offered). Next the Commission referred to *prices* (large supermarkets have a greater degree of pricing freedom). Lastly, the division into three distinct markets was also influenced by the *intended use* (small stores are mostly used for complementary purchases, that are limited in quantity or compelled by necessity). Again, this decision stands out because of its lack of reference to

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<sup>57</sup> *Continental Can*, *supra* note 9.

<sup>58</sup> *Promodes / Dirsra*, D. Comm., Dec. 12, 1990, 1990 O.J. (C 321) 16. This case affected the acquisition by DIA, the Spanish subsidiary of Promodes, of almost 100% of Dirsra. DIA and Dirsra are both active in the food retailing markets: Dirsra owns 895 self-service retail stores and supermarkets, DIA 362.

supply substitutability.<sup>59</sup>

In the *Aérospatiale / MBB* case,<sup>60</sup> the Commission had to review the merger of the helicopter activities of the French state-owned company *Aérospatiale* and the German company *Messerschmidt-Bölkow-Blohm GmbH (MBB)*. The product markets affected by the notified operation were the civil and military helicopter markets. The Commission first stated that the helicopter business is characterized by a strong link between the military and civil helicopter markets. To a significant degree, the development of new helicopters is subsidized by military budgets and civil helicopters are often derived from state-funded models. In spite of this interdependency, the Commission nevertheless held that military and civil helicopters constituted distinct relevant markets. It based its decision on the product characteristics, the structure of demand and the conditions of competition. These last two factors, which are to a large extent interrelated, have proven to be important criteria to the Commission in defining the relevant product markets. In the helicopter case they clearly had a decisive influence. In the military sector, the demand was almost purely national. Each of the merging companies had a 100% monopoly in its own state. The civil helicopter markets, on the contrary, are open for worldwide competition. Barriers to market entry are very low, resulting in a considerable mutual penetration of the markets between the EC, the USA and the rest of the world. These differences explain why the Commission preferred to treat civil and military helicopters as being in the distinct markets, instead of holding them in one market, as was suggested by the analysis of the supply side.<sup>61</sup>

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<sup>59</sup> Other examples of cases where the Commission based its product market definition principally on Section 5 of the notification form 'CO' are *Fiat Geotech / Ford New Holland*, D. Comm., Feb. 8, 1991, 1991 O.J. (C 118) 14; *Otto / Grattan*, D. Comm., March 21, 1991, 1991 O.J. (C 093) 6; *La Redoute / Empire*, D. Comm., April 25, 1991, 1991 O.J. (C 156) 10.

The merger proposed in the *Fiat Geotech / Ford New Holland* case primarily affected the agricultural machinery industry sector. The Commission divided this sector into three product markets (the tractor, the combined harvester and the hay and forage machine market), which were 'clearly distinguishable by function, price and technical design.' The Commission then stated:

Nevertheless, a number of producers, including both parties to the notified operation, supply all three products, and the overall market behavior of these full liners tends to reflect a global strategy prevailing within the industry. In addition, full liners distribute their products through a single dealer network, thereby enabling the latter to provide a full range of products to the farmer.

This statement asks for two remarks. First, one can wonder why the Commission didn't make a similar observation in the *Renault / Volvo* case, which was, given the characteristics of that case, perfectly possible. Second, doesn't this statement imply, at least to a certain extent, that the three relevant markets are in reality not as distinct as the Commission contended? We think it does and therefore deplore that the Commission didn't go further into the implications of its own observation.

<sup>60</sup> *Aérospatiale / MBB*, D. Comm., Feb. 25, 1991, 1991 O.J. (C 59) 13.

<sup>61</sup> It is remarkable that the Commission did not make an attempt to further subdivide the military and civil helicopter markets on the basis of size, price and intended use of the different types of

Structure of demand and conditions of competition played, together with marketing policies, a decisive role in at least three other Commission decisions, namely in the so-called 'battery' cases, *Magneti Marelli / CEAc*,<sup>62</sup> *Varta / Bosch*,<sup>63</sup> and in *Mannesmann / Boge*.<sup>64</sup>

In the battery cases, the Commission divided the starter battery sector into two distinct product markets: the original equipment (OE) market, including the supply of starter batteries to the automobile producers for the original equipment of new vehicles, and the replacement market, including the supply of batteries to the retail market for used cars. The Commission did not base this distinction primarily on different characteristics or different functions of the product, but mainly on "the fact that the conditions of competition differ significantly on the two markets, as a consequence of which the producers have to adapt their commercial and entrepreneurial policies to the different requirements of the two sales markets."<sup>65</sup> The OE market was characterized by a demand side composed of a limited number of clients, demanding just-in-time delivery of 100% reliable products on specific pallets. Moreover, supply to the OE market was mostly linked to R&D cooperation for new products with the automobile manufacturers. The replacement market, on the contrary, did not offer any of these characteristics. There were strong seasonal fluctuations in demand; a large number of battery types were offered; the clients varied from purchase organizations, wholesalers, car producers and department stores to ultimate dealers; and, finally, there was no control of quality by the costumers nor was there any cooperation as to R&D of new products. The Commission also referred slightly to the supply side, by stating that this distinction between the OE and replacement markets was 'common practice in the industry'<sup>66</sup> and by pointing to the parties' intention to recognize this division in the organization of their new joint venture.<sup>67</sup>

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helicopters. In particular, this broad distinction contrasts with the narrow product market definitions adopted in the majority of the Commission's decisions. *Compare*, *Renault / Volvo*, *supra* note 51; *Aérospatiale-Alenia / de Havilland*, *supra* note 20.

<sup>62</sup> *Magneti Marelli / CEAc*, *supra* note 19.

<sup>63</sup> *Varta / Bosch*, *supra* note 19.

<sup>64</sup> *Mannesmann / Boge*, D. Comm., Sept. 23, 1991, 1991 O.J. (C 265) 8.

<sup>65</sup> *Varta / Bosch*, *supra* note 63, at 13.

<sup>66</sup> *Id.* at 16.

<sup>67</sup> The *Mannesmann / Boge* case concerned the merger between the German companies *Mannesmann AG* and *Boge AG*. The market primarily affected was the shock absorber market, which was subdivided into two relevant markets, namely the OEM / OES market (compromising the supply of shock absorbers to the automobile industry) and the aftermarket (compromising the supply to independent spare part traders).

This distinction was not based on any substantial difference of the products: "Die Produkte . . . sind im Gegenteil praktisch identisch. Sie werden auf den gleichen Produktionsanlagen gefertigt

The third and smallest group of decisions comprises the cases where the Commission applied both a demand and a supply substitutability test.

In VIAG / Continental Can,<sup>68</sup> the Commission examined whether the beverage packaging market — which was one of the markets affected by the proposed acquisition — should be treated as one market, comprising glass, plastic and cans or whether this market should be further distinguished into different submarkets. First, it looked at the degree of interchangeability on the demand side, focusing on factors such as consumer preferences, price differences and the importance of each form of package for different kinds of beverages (for beer, only glass and cans were accepted, while for carbonated soft drinks, glass, plastic and cans were used). It also examined the possible effects of competition in the downstream market. However, given the low cost share of the packaging material in the sales price of the final filled product, price changes in the different packaging materials were not likely to provoke a switch by the beverage companies from one packaging material to another. Finally, the Commission took a look at the influence of the filling equipment on the choice of packaging material. Each packaging material, except tinplate and aluminium cans, required a different filling machine. Although all these five criteria pointed in the direction of distinct markets for each packaging material, the Commission nevertheless took a closer look at the supply side. Here it stressed that the use of differing manufacturing technologies and equipment made it “technically impossible to switch production from one packaging product to another.”<sup>69</sup> We fully support this analysis of both the demand and supply side in order to define the relevant market. However, we do not agree with the Commission’s conclusion of this perfect examination, stating that it was not necessary “to exactly delimitate [sic] the different product markets for the purposes of the present decision.”<sup>70</sup>

The Aérospatiale-Alenia / de Havilland case<sup>71</sup> concerned the joint

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und durchlaufen den gleichen Produktionsprozess. Stossdämpfer . . . unterliegen . . . darüber hinaus gewissen Sicherheitsstandards, die von den nationalen Behörden überwacht werden.” Mannesmann / Boge, *supra* note 64, at 10. The unique factors in the Commission’s decision were the conditions of competition on each of the relevant markets. It mainly referred to the same elements as in the battery cases (number of costumers, way to deliver the product, R&D cooperation). In addition, it pointed to different prices on each of the two markets.

While we are fully aware of the importance that has to be given to the structure of demand and conditions of competition, it is our opinion that the Commission simply went too far in this case: the products were the same and they were manufactured by the same workers, using the same machines. This should be enough to hold both products in the same market.

<sup>68</sup> VIAG / Continental Can, D. Comm., June 6, 1991, 1991 O.J. (C 156) 10.

<sup>69</sup> *Id.* at 13.

<sup>70</sup> *Id.* at 14.

<sup>71</sup> Aérospatiale-Alenia / de Havilland, *supra* note 20.

acquisition by Aérospatiale SNI and Alenia-Aeritalia e Selenia SpA of the assets of de Havilland, a division of the Boeing Company.<sup>72</sup> The product market affected by this proposed concentration was the regional turbo-prop aircraft market. The Commission first distinguished regional turbo-prop aircraft from regional jet aircraft. The acquisition and operating costs of the latter are much higher, while the time-saving they can bring about, is insignificant, given the limited distances for which turbo-props are operated.<sup>73</sup> Nor could the jet aircraft of around 100 seats, developed for short- and medium-haul flights, be held in the same market as the turbo-props. Again, there was a significant price difference. The former cost twice as much as the largest turbo-prop and there is a difference in use as well (the jet aircraft operated on longer routes with higher density). The Commission then went on to subdivide the turbo-prop market into three relevant product markets, namely commuters with 20 to 39 seats, 40 to 59 seats and 60 seats and over. This distinction corresponded to the views of the majority of customers and competitors who replied to the Commission's enquiries. Moreover the segmentation was also consistent with the entrepreneurial policies of the companies on the market.

The four manufacturers who had developed two types of turbo-prop aircraft — ATR, de Havilland, Saab and British Aerospace — all produced the second type in a different segment from the original one. It was improbable that a manufacturer would design a new type of commuter that would be in direct competition with a type in its existing product range. Finally, the Commission considered the possible supply-side substitutability between the different segments it had distinguished. It first stated that "there may be some possibility in the medium term for the commuter manufacturers to modify existing types (to 'stretch'), so as to develop a new competing product in a higher segment."<sup>74</sup> The Commission then made two remarks with regard to that statement, the first of which is noteworthy. It stated: "This does not affect the analysis that a type in one segment would not be substitutable for a type in another segment."<sup>75</sup> What does the Commission mean by this? If it only means that, from a demand-side point of view, the commuters belonging to dis-

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<sup>72</sup> Aérospatiale and Alenia are a French and an Italian company, both active in the aerospace industries. Since 1982, they jointly manufacture and sell regional transport aircraft under the name ATR (Avions de Transport Regional). At the time of the proposed acquisition, they sold two regional turbo-prop aircraft types on the market.

De Havilland is also solely active on the regional turbo-prop aircraft market with two types of aircraft.

<sup>73</sup> Time savings would only become considerable for routes of 400 to 500 nautical miles, while 85% of the regional transport aircraft flights are in fact below 400 nautical miles.

<sup>74</sup> Aérospatiale-Alenia / de Havilland, *supra* note 20, at 14.

<sup>75</sup> *Id.*

tinct segments are not substitutable, then the observation is superfluous, because the Commission had made that clear before. If, on the other hand, this remark implies that, even if there would exist a high elasticity of supply, this would still not be enough to change the (demand-side based) product market definition, then we are compelled to strongly criticize this observation. We are fully aware that, in this specific case, the substitutability of supply is low, given the number of years it would take to design and develop a commuter in a different segment,<sup>76</sup> but we are surprised by the generality of the observation. As we already indicated, the Commission never had “a great love” for elasticity of supply.<sup>77</sup> We believe that it is this aspect of product market definition that should receive greater attention in all Commission decisions with regard to mergers, at least in those decisions that declare a merger incompatible with the Common Market.<sup>78</sup>

### 3. *Comparison With U.S. Law*

Many, if not all, of the criteria used by the Commission in defining the relevant product markets, also play an important role in the leading Supreme Court cases and in the 1984 Merger Guidelines.<sup>79</sup>

Thus, the famous list of indicia in *Brown Shoe*<sup>80</sup> that may be used to determine the existence of a relevant submarket within the boundaries of a broader market, is very similar to the criteria applied by the Commis-

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<sup>76</sup> This was stressed by the Commission in its second remark, when it said: “Furthermore, . . . it would take considerable time, longer than three or four years, for manufacturers for example of 30-seat aircraft to switch their facilities to produce 50-seat aircraft, to the extent that these facilities already exist.”

<sup>77</sup> Cf. *Continental Can*, *supra* notes 9 and 59.

<sup>78</sup> The *Tetra Pak / Alfa-Laval* case, D. Comm., July 19, 1991, 1991 O.J. (L 290) 35, can also be held to belong to the third group of decisions that we distinguished. In particular, this decision distinguishes itself from the second group of cases, because of the economic vocabulary used by the Commission in assessing the relevant markets. One of the markets affected by the acquisition of the Swedish company Alfa-Laval by the Swiss company Tetra Pak, was the market for machines used for the packaging of liquid foods in cartons under aseptic conditions. The Commission distinguished these machines from non-aseptic packaging machines by referring to the ‘classical’ criteria such as the nature of the end-product, its distribution method, taste and price. It was, however, noteworthy that, at various instances, the Commission referred directly to demand elasticity by asking the question how consumers would react to ‘a small but significant price rise.’ All the inquiries of the Commission indicated that the price-elasticity of demand between aseptic and non-aseptic packaging machines was very low.

Although, the Commission didn’t refer to supply substitutability in its analysis of the relevant product market, it took a closer look to both supply-side substitutability and barriers of entry, when it had to determine whether Tetra Pak held a dominant position on the previously defined relevant market.

<sup>79</sup> 1984 Merger Guidelines, *supra* note 12. As we have indicated above, the changes brought about by the 1992 Horizontal Merger Guidelines will be explained in footnotes.

<sup>80</sup> *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

sion in most of its decisions. The list refers to peculiar characteristics and uses of the product, as well as to its distinct price, three criteria which form the basis of the definition of Section 5 of the form 'CO.' Other indicia that have to be taken into account are the fact that there might be distinct costumers and specialized vendors for a certain product and the recognition by the public or the industry of the submarket as a separate economic entity. We think that these elements largely correspond to criteria such as structure of demand, conditions of competition and marketing policies, factors that had a decisive influence in several of the Commission's decisions.<sup>81</sup> Finally, *Brown Shoe* also pointed out the importance of supply substitutability by recognizing that "cross-elasticity of production facilities may . . . be an important factor in defining a product market . . . ."<sup>82</sup>

The 1984 DOJ Guidelines likewise refer to most of the same criteria that have been applied by the Commission. But we find almost no reference to factors as conditions of competition, structure of demand and marketing policies. This is a significant difference, given the important role the latter criteria have in the Commission's definition of the relevant product market.

Nevertheless, it is our opinion that the most important difference in product market definition between the U.S. and the E.C. is not so much in the nature of the criteria used as in the relative weight that is given to each of them and to the way they are combined with each other. In this context, the Guidelines are of great significance, because they offer a clear, structured approach towards the different aspects of product market definition. As we have indicated above, it is such a balanced approach

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<sup>81</sup> See, e.g., *Aérospatiale / MMB*, *supra* note 60; *Magneti Marelli / CEAc*, *supra* note 62; *Varta / Bosch*, *supra* note 63; *Mannesmann / Boge*, *supra* note 64.

<sup>82</sup> *Brown Shoe Co.*, 370 U.S. at 325 n.42. Philadelphia National Bank is another leading case on market definition. Here, the Supreme Court held that the relevant product market was the aggregate of various kinds of credits and services provided by banks. It therefore quoted three main reasons. First, some of the services or products provided by banks were so distinctive that there was no effective competition with products or services of other financial institutions: e.g., the checking account. Second, other services or products, such as loans, were likewise offered by other financial institutions, but here a distinction could be drawn on the basis of significant differences in price. Finally, for a certain number of banking facilities, effective competition with the facilities offered by other financial institutions could exist, but the Court stated that there existed "a settled consumer preference" which insulated the former to a significant degree from competition with the latter. *United States v. Philadelphia National Bank*, 374 U.S. 321 (1963).

Other leading U.S. cases on product market definition are *United States v. Aluminum Co. (Rome Cable)*, 377 U.S. 271 (1964); *United States v. Continental Can Co.*, 378 U.S. 441 (1964); *United States v. Bethlehem Steel Corp.*, 168 F. Supp. 576 (S.D.N.Y. 1958); *Calnetics Corp. v. Volkswagen of America*, 532 F.2d 674 (9th Cir. ).

For a general appreciation of the market definition in these cases, see AREEDA & TURNER, *supra* note 41, at 419-30.

that is still missing in the EC. Therefore, it might be interesting to focus for a moment on the Guidelines.

In order to define the relevant product market, the Guidelines start by identifying each of the products produced by the merging firms and then question what would be the effect of a 'small but significant and nontransitory' increase in price<sup>83</sup> by a hypothetical monopolist of that product. If the price increase would induce "so many buyers to shift to other products that a hypothetical monopolist would not find it profitable to impose such an increase in price, then the Department will add to the product group the product that is the next best substitute . . . and ask the same question again. This process will continue until a group of products is identified for which a hypothetical monopolist could profitably impose a 'small but significant and nontransitory' increase in price."<sup>84</sup>

While this initial approach thus exhibits a vast confidence in price-elasticity of demand,<sup>85</sup> the Guidelines nevertheless take into account the difficulty of directly demonstrating this elasticity. That is why they also refer to factors such as physical and technical characteristics of a product, customary usage, price movements, and perceptions of buyers and sellers that two products are or are not substitutes.<sup>86</sup>

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<sup>83</sup> Generally, the DOJ will use the prevailing prices of the different products, although in some cases (mainly when price changes can be predicted with acceptable certainty) likely future prices may be used. In determining the effect of a 'small but significant and nontransitory' increase in price, the Department will in most cases use a price increase of five percent lasting one year. However, this rule is no more an absolute one, as the Guidelines foresee that "what constitutes a 'small but significant and nontransitory' increase in price will depend on the nature of the industry, and the Department at times may use a price increase that is larger or smaller than five percent." 1984 Merger Guidelines, *supra* note 12, at 26,828. Note that a small change has been introduced here by the 1992 Guidelines. A 'small but significant and non-transitory' increase in price is now interpreted as a price increase of five percent lasting for the foreseeable future, instead of during one year. 1992 Merger Guidelines, *supra* note 13, at 20,573. For an insightful criticism of this 'five percent test,' see Schaerr, *supra* note 15.

<sup>84</sup> 1984 Merger Guidelines, *supra* note 12, at 26,828.

<sup>85</sup> As we have indicated above, a similar confidence in price-elasticity of demand can be found in at least one Commission decision, namely in the Tetra Pak / Alfa Laval case, *supra* note 78. Nevertheless, in the large majority of the Commission's decisions, no such direct reference to price-elasticity of demand can be found.

<sup>86</sup> These same criteria also play an important role under the EC Merger Regulation. It is our opinion, however, that these criteria are used in a significantly different way in the U.S. than in the EC.

Indeed, the Guidelines look at these factors as criteria that indicate the likely effect of a price increase or, in other words, the price-elasticity of demand. It is the answer to this basic question that will determine whether or not a certain substitute will be included in the product market. In the EC, on the contrary, these same criteria are applied to directly answer the final question whether a substitute will be included in the relevant product market.

None of these criteria are explicitly mentioned in the new 1992 Guidelines. However, it would be incorrect to pretend that these factors have lost all significance. Indeed, perceptions of sellers and buyers that two products are or are not substitutes still have a central place in the Guidelines'



Once the relevant product or service is thus indicated, the next step is identifying the firms that manufacture this product or offer this service. Here, the Guidelines not only focus on the firms actually producing and selling the relevant product, but also include in the market those firms that have "existing productive and distributive facilities that could easily and economically be used to produce and sell the relevant product within one year in response to a 'small but significant and nontransitory' increase in price."<sup>87</sup> However, firms that have the productive facilities to switch the production from one product to another within one year, but lack the adequate means to properly distribute and market them, will not be included in the market. They will be considered at a later stage in the inquiry, namely when evaluating the ease of entry.<sup>88</sup>

The point we want to make by summing up the Guidelines' approach towards product market definition is a double one. First, the Guidelines offer a clear basis of reference on which firms, planning a merger, can rely to define the product market. This cannot be said of the definition of product market in Section 5 of form 'CO,' a definition that contains only a small part of the criteria that have been applied by the Commission to define the product market. Of course, firms are free to take a closer look at the cases decided by the Commission under the Regulation, but, apart from the considerable amount of time such an

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analysis, even if the wording has changed somewhat. The Guidelines now state: "In considering the likely reaction of buyers to a price increase, the Agency will take into account all relevant evidence, including, but not limited to, the following: (1) evidence that buyers have shifted or have considered shifting purchases between products in response to relative changes in price or other competitive variables; (2) evidence that sellers base business decisions on the prospect of buyer substitution between products in response to relative changes in price or other competitive variables; (3) the influence of downstream competition faced by buyers in their output markets; and (4) the timing and costs of switching products." 1992 Merger Guidelines, *supra* note 13, at 20,572-73. It is clear that not only the perceptions of buyers and sellers as to the substitutability of products, but also physical and technical characteristics of products as well as their customary usage, will influence the above factors.

The Guidelines likewise refer to price discrimination. When price discrimination is possible, then the DOJ "will consider defining additional, narrower product markets consisting of particular uses of the product for which a hypothetical monopolist could profitably impose a 'small but significant and nontransitory' increase in price." *Cf.* 1984 Merger Guidelines, *supra* note 12, at 26,828.

<sup>87</sup> 1984 Merger Guidelines, *supra* note 12, at 26,829.

<sup>88</sup> The significance of durable products and of internal consumption is also stressed by the Guidelines. As regards durable products, they foresee that, if recycled or reconditioned products are good substitutes for new products, the recycling or reconditioning firms will be included in the market.

Concerning the internal or captive consumption of the relevant product by vertically integrated firms, the Guidelines state that they will be included in the market if these firms respond to a five percent price increase by either starting to sell the relevant product or by continuing their internal consumption, but simultaneously increasing the "production of both the relevant product and the products in which the relevant product is embodied."

examination would ask, we don't think it would be possible to discern one clear approach towards product market definition, as we have indicated and demonstrated above. Sometimes some criteria are stressed, while others are left aside; in other cases, it is the latter that will influence the market definition, while the former are left out.

This leads us to the second important advantage of having guidelines. Whatever the nature of criteria you want to take into account, well drafted-guidelines will outline a path that will lead you along every criterion you have decided to be relevant in defining the product market. In this manner, you will avoid, or at least limit, the number of cases where you don't pay any attention to, for instance, supply substitutability, simply because it will be a substantial part of your approach towards market definition.

For the above reasons, we would urge the Commission to issue 'market definition guidelines.' The Commission has already announced its intention to do this,<sup>89</sup> but up to now, none have been released.<sup>90</sup>

## Section 2: Defining the Relevant Geographic Market

### 1. *Economic Analysis*

Once you have determined the relevant product and its acceptable substitutes and once you have identified the firms producing this product or its substitutes as well as the firms that are able to quickly and cheaply switch their production towards these products, another question remains to be answered, namely to what extent will geographically dispersed firms be considered in the relevant market? It is not possible to give one general answer to this question. For some products there exist world markets, for others the relevant geographic market will be the European Community, the territory of one member state or even a smaller region. What then, from an economic point of view, are the relevant criteria and significant indicia, that can help us to draw the outer boundaries of the relevant geographic market? That is the question we will try to answer in this economic analysis.

Generally speaking, the ability of remote firms to limit possible market power of the merging firms will depend on the significance of the

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<sup>89</sup> Cf. Joseph F. Winterscheid, *The EC Merger Regulation One Year Later*, ANTITRUST, Spring 1992, at 30, 31.

<sup>90</sup> With regard to two other notions of the Regulation, namely ancillary restraints and the distinction between concentrative and cooperative joint ventures, the Commission has already issued guidelines. See Commission notice regarding restrictions ancillary to concentrations, 1990 O.J. (C 203) 5; Commission notice regarding the concentrative and cooperative operations under Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings, 1990 O.J. (C 203) 10.

barriers to interregional trade, such as transport costs, consumer preferences, cultural and language differences, tariffs or other legal limitations.<sup>91</sup> Other criteria that are often used to decide whether two areas should be placed in the same market are price differences and price movements, together with sales and purchasing patterns.<sup>92</sup> As will be shown, it is only by combining the aforesaid factors, that one can arrive at acceptable definitions of the geographic market.

First of all, a basic distinction has to be drawn between cases where imports<sup>93</sup> are absent or episodic and cases where persistent imports exist. The absence of imports is often said to indicate that remote firms are not in the same market as local firms.<sup>94</sup> When local prices are competitive and demand and supply are in equilibrium, remote suppliers won't be induced to sell in the local area. In this hypothetical, a close relationship between local and remote prices would exist. Metropolitan grocery markets can be cited as an example here.<sup>95</sup> Buyers in area A won't shop in area C, but buyers from both areas A and C may shop at the margin in area B. Consequently, grocery sellers may treat the entire metropolitan area as the relevant geographic market for the determination of their prices.<sup>96</sup>

When on the other hand, significant and persistent imports exist, a further distinction has to be made, namely between one-way and two-way sales. We will discuss each of these situations.

The presence of persistent one-way shipments is only relevant when assessing a merger between two firms of the 'importing' area or between firms from both the 'importing' and 'exporting' area.<sup>97</sup> The fundamental

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<sup>91</sup> Areeda, *supra* note 22, at 572.

<sup>92</sup> AREEDA & TURNER, *supra* note 41, at 355-58. Much of this summary economic analysis is based on the Areeda-Turner treatise.

<sup>93</sup> The term 'import' is used here to indicate sales in the local area of a product that has been manufactured in a remote area, while the barriers to interregional trade are significant. Once we conclude that the remote firms are in the same market as the local suppliers, the 'import' terminology is no longer legally relevant.

<sup>94</sup> Areeda, *supra* note 22, at 572.

<sup>95</sup> *Id.* at 573.

<sup>96</sup> However, close price relationships are not always indicative that two areas should be held to be in the same market. In some cases, similar prices and price movements in actual distinct markets can, for instance, be explained by similar costs or demand forces.

For all that, when prices are alike and move with similar magnitude in similar directions, a presumption of a single market can be made. By proving significant transport costs, other substantial barriers to interregional trade, or the limited influence of actual interregional sales, this presumption can be overcome.

<sup>97</sup> In the opposite case, namely when assessing a merger between two firms of the 'exporting' area, the presence of persistent one-way sales ordinarily indicates that the exporting area should be treated as a separate market, unless, of course, the relevant product is imported from other areas into this 'exporting' area.

question that has to be resolved in these cases concerns the weight to be assigned to the imports into the local market. Indeed, here we are confronted again with the dilemma already faced when defining the relevant product market. If you only include present imports, then you might significantly understate the influence of the remote suppliers on the market power of the local firms. If, on the other hand, you include the complete output or capacity of the distant firms, a danger exists that you will greatly understate the local suppliers' market power. Nevertheless, Professors Areeda and Turner defend this last option, but limit its application to the situation where the local price exceeds the remote price by at least the amount of transportation costs.<sup>98</sup> A similar general conclusion, but without the qualification concerning transportation costs, is expressed by Professors Landes and Posner.<sup>99</sup>

There are, however, several 'caveats' which have to be taken into account when including the entire remote production or output in the relevant market.<sup>100</sup> Various factors might indeed limit the ability of remote suppliers to increase their actual sales into the local market following a rise of the local price. It is possible that the transportation facilities are not equipped to deal with suddenly increased volumes or that remote producers are bound by existing long-term commitments. Also, unless excess capacity is available, greater exports into the local market will lead to lower output and, thus, higher prices in the remote market, which will discourage remote suppliers from continuing to export to the local market. Taking into account these arguments should lead us to the awareness that, if you include, as a general rule, the total output or capacity of the remote firms in the relevant market, a realistic danger exists of overstating their influence on the possible market power of the merging firms. Therefore, an adjustment should be made when interpreting the market share data.

When transport costs are higher than the difference between the local and the remote price, but persistent one-way imports are nevertheless present, this implies that remote suppliers are earning less on exports than on home sales. Consequently, they are less likely to increase exports in response to a local price rise, simply because, unless excess capacity

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<sup>98</sup> AREEDA & TURNER, *supra* note 41, at 358-65.

<sup>99</sup> See William M. Landes & Richard A. Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937 (1981). This article has brought about a wide academic debate in the United States. For criticism of Landes and Posner, see, e.g., Richard Schmalensee, *Another Look at Market Power*, 95 HARV. L. REV. 1789 (1982); Timothy J. Brennan, *Mistaken Elasticities and Misleading Rules*, 95 HARV. L. REV. 1849 (1982); Louis Kaplow, *The Accuracy of Traditional Market Power Analysis and a Direct Adjustment Alternative*, 95 HARV. L. REV. 1817 (1982).

<sup>100</sup> See generally Hawk, *supra* note 32, at 776.

exists, this would drop their local sales, on which they are making greater profits. In order to determine the exact change of the amount of imports in response to a local price change, it will be necessary to determine the elasticities of demand in the local and remote markets, which is, in practice, almost impossible. For the above reasons as well as for the aforementioned 'caveats,' we are inclined to include only the actual sales by exporters in the 'importing' area in those cases where the transport costs exceed the price difference between the local and remote market. When interpreting the obtained market shares, we should then take into account that a slight upward adjustment has to be made. This solution is reconcilable with the one proposed by Areeda and Turner.<sup>101</sup> Although they incline toward including the total sales of the remote firms, they recognize that whichever approach one takes — including only the actual sales versus the total sales — corresponding adjustment is essential. They add that, ultimately, this choice might be influenced by the nature of the substantive horizontal merger rules: "The more severe the prohibition of mergers involving relatively modest market shares, the more appropriate it would be to adopt the second approach."<sup>102</sup>

Finally, the presence of persistent or recurring two-way sales ordinarily indicates that there is a single market, including both local and remote producers. However, when transport costs are proven to exceed the possible price difference between the two areas, this presumption cannot be maintained and each area should be treated as a separate market. Indeed, in these circumstances, two-way shipments signify that sellers in each area earn lower profits on their sales to the other area. Consequently, prices in each area are non-competitive, showing the inability (or unwillingness?<sup>103</sup>) to act as an effective competitive check.

Customer convenience and preference — such as the immediate availability of a repair service or of the product itself — is another factor that has to be taken into account when defining the relevant geographic market.<sup>104</sup> Indeed, even when transportation costs are very limited, this criterion can sometimes narrow the geographic scope of a market.

In this regard, two significant situations can be distinguished,

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<sup>101</sup> AREEDA & TURNER, *supra* note 41, at 367.

<sup>102</sup> *Id.* It is noteworthy that Landes and Posner also propose to include the total remote output, but without downward adjustment, mainly because the remote price is sufficiently above production costs that the exports generate at least the fully competitive returns. Landes & Posner, *supra* note 99, at 963-66. However, this doesn't alter the basic fact that the remote suppliers accept lower net returns on exports than they do on home sales and therefore that diversion is far less likely here, as it is when the local price exceeds the remote price by at least the amount of transportation costs.

<sup>103</sup> This situation might indeed indicate the existence of a cartel or a well-managed tacit price coordination. See Areeda, *supra* note 22, at 573-74.

<sup>104</sup> Areeda & Turner, *supra* note 41, at 367.

namely, one where no common sellers are present, and one where significant common sellers are present. When common sellers are absent, and a barrier to interregional trade in the form of costumer preferences is present, the two areas constitute separate markets, that will each include the total sales in that area respectively.<sup>105</sup> In the opposite situation, where significant common sellers are present, but where the only barrier inhibiting interregional trade is still localized consumer preference, the areas ordinarily should be held to constitute a single market.<sup>106</sup>

A final remark that has to be made in this economic analysis concerns the effect of foreign competition and imports on geographic market definition, an issue that has received considerable academic attention since about 1980.<sup>107</sup> Prior to the 1980's, antitrust cases usually proceeded as if foreign imports were no more relevant than their current volume.<sup>108</sup> Foreign imports differ from imports from a distant location within a country, since the crossing of the border itself may constitute a barrier to interregional trade: customs duties, import quotas and fluctuating monetary units are all factors that can restrict or complicate international transactions. Moreover, government policies have a particularly important influence on international trade. They can, for instance, restrict or encourage exports through, respectively, imposing voluntary export restraints, or subsidizing or favorably taxing exporting industries. Finally, these policies can be specially volatile and there is no way to predict the direction or the intensity of possible future changes. Nevertheless, given the growing importance of international trade, there might be a danger of significantly understating the foreign constraint on domestic prices if only present imports in the market are included. On the other hand, including the complete foreign output, would clearly be inappropriate.<sup>109</sup> The best solution to this problem is probably to include only

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<sup>105</sup> *Id.* 367-68.

<sup>106</sup> Obviously, the total sales of the common sellers should be included in the market, since there are no barriers that prevent them to divert their sales to one of the areas in which they are active in response to a price rise. But the total sales of the 'non-common' suppliers should also be included, basically because they affect the pricing behavior of the common sellers. *See, AREEDA & TURNER, supra* note 41, at 368-70. Note that a third situation can still be distinguished, namely where 'limited common sellers' are present. For this hypothetical, Areeda and Turner construed a rather theoretical rule based on the relative importance of the 'outside' sales of the common sellers. However, as they state themselves that this particular situation is not "worth much attention in practice," we won't go deeper into this matter.

<sup>107</sup> *Cf. Alden F. Abbott, Foreign Competition and Relevant Market Definition under the Department of Justice's Merger Guidelines*, 30 ANTITRUST BULLETIN 299, 301-02 (1985).

<sup>108</sup> AREEDA & HOVENKAMP, *supra* note 14, at 551.

<sup>109</sup> This is the solution proposed by Landes and Posner. Landes & Posner, *supra* note 99, at 963-69. *See, however*, the criticism of this approach by Brennan and Kaplow. Brennan, *supra* note 99, at 1851-52; Kaplow, *supra* note 99, at 1836-44.

the actual imports in the market, but at the same time fully recognize that an upward adjustment should be made.<sup>110</sup> In other words, the deciding authority will have to make an 'educated guess' as to the question to what extent an increase of imports, in answer to a price increase on the local market, is realistic.

## 2. *Geographic Market Definition Under the New Merger Regulation*

Article 9 (7) of the EC Merger Regulation defines the relevant geographic market as:

the area in which the undertakings concerned are involved in the supply of products and services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighboring areas because, in particular, conditions of competition are appreciably different in those areas. This assessment shall take account in particular of the nature and characteristics of the products and services concerned, of the existence of entry barriers or of consumer preferences, of appreciable differences of the undertakings' market shares between the area concerned and neighboring areas, and of substantial price differences.

Before examining how this definition has been applied by the Commission, it may be helpful to make a few preliminary remarks. It is noteworthy that this definition is given in the context of the referral of cases to the competent authorities of member states because of a 'distinct market' problem<sup>111</sup> and is named 'geographical reference market.' However, it is completely repeated in Section 5 of the form 'CO' under the heading 'relevant geographic market.'<sup>112</sup> This is not a coincidence, since the wording reflects to a large extent the definition of the relevant geographic

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<sup>110</sup> This solution is also proposed by Areeda and Turner, *supra* note 41, at 552, and is reconcilable with the conclusions of Hay, Hilke and Nelson. George Hay et al., *Geographic Market Definition in an International Context*, in *INTERNATIONAL MERGERS AND JOINT VENTURES* 51, 82-83 (Barry Hawk ed., 1991).

<sup>111</sup> Article 9 of the Regulation foresees a possibility for the Commission to refer a notified concentration to the competent authorities of a member state if this concentration "threatens to create . . . a dominant position as a result of which effective competition would be significantly impeded on a market, within that Member State, which presents all the characteristics of a distinct market, be it a substantial part of the common market or not." Cf. Article 9(2) of the Regulation.

This provision has been included at the insistence of Germany and is therefore often referred to as the 'German clause.' See generally T. ANTHONY DOWNES & JULIAN ELLISON, *THE LEGAL CONTROL OF MERGERS IN THE EUROPEAN COMMUNITIES* 79-83 (1991); Hawk, *supra* note 5, at 218.

Up to now, the Commission has only referred one notified concentration to national authorities, namely in the Steetley / Tarmac case, D. Comm., Feb. 12, 1992, 1992 O.J. (C 50) 25. This case concerned a proposed joint venture involving building materials between the aforementioned British companies. With regard to two of the markets affected by this joint venture, the market for bricks and the market for clay roofing tiles, the Commission decided to refer the matter back to the competent United Kingdom authorities.

<sup>112</sup> Commission Regulation (EEC) No 2367/90 of 25 July 1990 on the notifications, time limits

market as it has been developed in the case law of the European Court of Justice.<sup>113</sup>

It is further remarkable that the definition mainly seems to focus on demand-side phenomena such as price and brand differences or disparities in market shares. Again, no reference is made to supply patterns.<sup>114</sup> The definition does not talk about how the chain of supply works, where production is organized or what the supply-side looks at as the relevant geographic market. No more is there much reference to potential barriers to the circulation of goods or services, such as technical standards, regulatory barriers or transportation costs, although one could argue that these elements are part of 'the existence of entry barriers,' which is one of the criteria that has to be taken into account.<sup>115</sup> However, just as the Commission did not limit itself to the criteria of Section 5 of the form 'CO' when defining the relevant product market, nor does it pay too much attention to the definition of Article 9(7) of the Regulation. As will be shown, the latter criteria have played a considerable role in defining the relevant geographic market.

A final preliminary remark that needs to be made, is a more general one and concerns the general nature of markets within the European Community. Although the 'magic date' December 31, 1992, has already passed, it is nevertheless clear that for many products or services community-wide markets are still far away. This is completely normal, since for over 50 years, companies in many sectors have based their production, marketing, distribution and purchasing policies on national rather than on international considerations.<sup>116</sup> Surely, this is rapidly changing, but nevertheless the process of integration requires time. The 1992 process has already done away with many barriers to interregional trade, but many more still need to be removed.<sup>117</sup> It remains, however, that many product and service markets are markets in full evolution, a quality that does not facilitate the definition of geographic relevant markets. We will

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and hearings provided for in Council Regulation (EEC) No 4064/89 on the control of concentrations, 1990 O.J. (L 219) 5, at 15.

<sup>113</sup> Cf. EEC COMPETITION LAW, *supra* note 5, at 363 n.103.

<sup>114</sup> James S. Venit, *Substantive Review under the Merger Regulation, Panel Discussion*, 1990 FORDHAM CORP. L. INST. 561, 569-70 (Barry Hawk ed., 1991).

<sup>115</sup> Cf. EEC COMPETITION LAW, *supra* note 5, at 364-65.

<sup>116</sup> Michael J. Reynolds, *The First Year of Enforcement under the EEC Merger Regulation*, 1990 FORDHAM CORP. L. INST. 696, 719 (Barry Hawk ed., 1991).

<sup>117</sup> Some barriers, like cultural and language barriers, will probably never disappear and it is arguable that we should not attempt to do away with them, since this diversity of languages and cultures constitutes perhaps one of the most peculiar characteristics of Western Europe or even of the whole of Europe.



now focus on the Commission's decisions in order to find out how the Commission has coped with this complicated task.

It is fair to say that the Commission has taken a realistic approach towards the issue of geographic market definition<sup>118</sup> and that it has not been led by 'wishful thinking' that markets should be community-wide. As we will show, in only a limited number of the cases we analyzed, has the Commission held the markets to be community-wide. In most of its decisions, the outer boundaries of the geographic markets coincide with the national borders of the member states.

Nor can it be said that the Commission has 'idolized' the definition of the geographic market. Rather, its approach can be called pragmatic: in an important number of cases, the Commission has simply stated that it was "not necessary to determine whether or not the geographic market . . . is a Community market or is still composed of several national markets,"<sup>119</sup> mainly because the proposed concentration "did not create or strengthen a dominant position . . . on either of these geographic markets."<sup>120</sup>

We will now illustrate each of these three important groups of decisions and scrutinize the criteria used by the Commission to arrive at these market definitions.

With regard to the first group of decisions, where the Commission does not arrive at a specific geographic market definition, its justification is in all instances very concise and comes down to saying that defining a precise geographic market is unnecessary, since the concentration does not raise any problems, however one defines the geographic market.<sup>121</sup> This approach thus evades the delicate issue of defining relevant geographic markets when the overall market structures are rapidly integrating. At the same time, it attempts to insulate the clearance decision from criticism, since it implies that the 'dominant position-test' has been ap-

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<sup>118</sup> Cf. Winterscheid, *supra* note 89, at 32.

<sup>119</sup> Renault / Volvo, *supra* note 51, at 11.

<sup>120</sup> *Id.*

<sup>121</sup> See, e.g., Volvo / Renault, *supra* note 51, at 11, 16; AG / Amev, *supra* note 45, at 11-13; ICI / Tioxide, *supra* note 50, at 17; Fiat Geotech / Ford New Holland, *supra* note 59, at 16; Dräger / IBM / HMP, *supra* note 49, at 16; ICL / Nokia Data, D. Comm., July 17, 1991, 1991 O.J. (C 236) 6; EDS / SD Scicon, D. Comm., July 17, 1991, 1991 O.J. (C 237) 44; Digital / Philips, D. Comm., Sept. 2, 1991, 1991 O.J. (C 235) 7, at 10. Volvo / Lex, D. Comm. May 21, 1992, 1992 O.J. (C 142) 18; Ericsson / Acsom, D. Comm. July 8, 1992, 1992 O.J. (C 201) 26; PepsiCo / General Mills, D. Comm. August 5, 1992, 1992 O.J. (C 228) 6; Northern Telecom / Matro Telecommunication, D. Comm. August 10, 1992, 1992 O.J. (C 240) 15; Rhône Poulenc Chimie / SITA, D. Comm. Nov. 26, 1992, 1992 O.J. (C 319) 6; Del Monte / Royal Foods / Anglo American, D. Comm. Dec. 9, 1992, 1992 O.J. (C 331) 13.

plied to both the smaller — read “national” — and the wider — read “Community” — geographic market.

Nevertheless, we have some objections to this approach. First, as we already indicated when examining the Commission’s attitude toward product market definition, this approach has the immediate effect of limiting the future weight of the decisions concerned, since one of the most crucial questions — what territory should be deemed geographically relevant for a certain product — is left unanswered. Moreover, we are of the opinion that, at least in some of the cases belonging to this group, there are sufficient indications to define the market in one way or the other. We will illustrate this with three examples.

One of the markets affected in the ICL / Nokia Data case<sup>122</sup> was the market for personal computers. The same personal computer market was also affected by the acquisition of NCR by AT&T.<sup>123</sup> In this latter decision, the Commission stated that personal computers were “to be considered on a Community-wide level.”<sup>124</sup> In support, it referred to the absence of significant price differences between the member states as well as to the fact that all major competitors were represented in all member states. We seriously wonder whether the PC market has lost these two characteristics during the six months that separated the two aforementioned mergers from one another. Another decision where we think the Commission could have defined a community-wide market, rather than abstaining from defining the relevant geographic area, is the Volvo / Renault case.<sup>125</sup> With regard to two of the markets affected by this proposed joint venture, the truck and the coach market, the Commission left geographic market definition as an open question.

In our opinion, there were at least three reasons to define a Community-wide market. First, both Renault and Volvo as well as all other major suppliers were present in every EEC country. Second, these product markets were “performing in a highly competitive way both with regard to innovation and prices,”<sup>126</sup> which, we think, indicates that the conditions of competition were sufficiently homogeneous.<sup>127</sup> Finally, buyers of both trucks and coaches became increasingly fleet buyers, moving towards a European purchasing policy and being able to exercise “a

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<sup>122</sup> ICL / Nokia Data, *supra* note 120.

<sup>123</sup> AT&T / NCR, D. Comm., Jan. 18, 1991, 1991 O.J. (C 016) 20.

<sup>124</sup> *Id.* at 6.

<sup>125</sup> Volvo / Renault, *supra* note 51.

<sup>126</sup> *Id.* at 14.

<sup>127</sup> The Commission added to this that the prices in France were among the most competitive of the EEC. However, we don’t think that this statement negates the existence of homogeneous conditions of competition.

considerable downward pressure on prices by transferring their demand to the countries with the lowest prices."<sup>128</sup> We think these three characteristics of both truck and coach markets should suffice to hold the Community as the relevant geographic market.

Finally, the AG / Amev case<sup>129</sup> presented an opportunity to define a smaller market, coinciding with national boundaries. The Commission was on the right track when it stated that "the relevant geographic markets for the insurances in question seem to be the national markets of each member state."<sup>130</sup> It mainly based this finding on the significant differences that exist between the member states as to risk levels, distribution systems and public supervision and regulation of markets. In other words, both from the demand and the supply-side, there were very important barriers to international trade. By the way, this is confirmed by the actual situation of the merging companies: although both AG and Amev were active in several EC counties, by far the largest part of their income stemmed from, respectively, Belgium and the Netherlands. Despite these clear indications of the existence of national markets, the Commission surprisingly held that "the question can remain open," since "even on the narrow basis of national insurance markets, . . . , the merger does not raise serious doubts."<sup>131</sup> In our opinion, geographic market definition should not be influenced by whether the proposed merger involves high or low market shares and thus whether it raises serious doubts or not. Where we can still accept that given the particular circumstances of a specific case, it may be extremely difficult to indicate a relevant geographic market, we strongly question the Commission's practice of often leaving the geographic market definition an open question when the proposed concentration poses little doubt as to its compatibility with the common market.

The second and largest group of cases comprises decisions where the Commission has defined the relevant geographic market along the national borders of member states.<sup>132</sup> Within this group a further distinction can be made between cases involving companies that mainly or

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<sup>128</sup> Volvo / Renault, *supra* note 51, at 14.

<sup>129</sup> AG / Amev, *supra* note 45.

<sup>130</sup> *Id.* at 12.

<sup>131</sup> *Id.* at 13.

<sup>132</sup> See, e.g., Volvo / Renault, *supra* note 51, at 17; Aérospatiale / MBB, *supra* note 60, at 10-13; Otto Versand / Grattan, *supra* note 59, at 11; La Redoute / Empire, *supra* note 59, at 12; Alcatel / Telettra, D. Comm., April 12, 1991, 1991 O.J. (L 122) 48, at 52; ELF / BC / CEPESA, D. Comm., June 18, 1991, 1991 O.J. (C 172) 8, at 10-14; BP / Petromed, D. Comm., July 29, 1991, 1991 O.J. (C 208) 24, at 8-12; Thomson / Pilkington, D. Comm., Oct. 23, 1991, 1991 O.J. (C 279) 10, at 21-24; Magneti Marelli / CEAc, *supra* note 62; Varta / Bosch, *supra* note 63, at 31-32. Accor / Wagons Lits, *supra* note 19; Thomas Cook / LTV / West LB, D. Comm. July 14, 1992, 1992 O.J. (C 199) 12.

uniquely sell to public authorities and cases involving firms that mainly sell their products to private costumers. Indeed, the criteria used by the Commission to arrive at national markets significantly differ for each of these two 'sub-groups.'

With regard to the former, the Commission's justification is continually very succinct. It refers only to the strong influence of national buying preferences, as well as to the existence of specific technical requirements — both characteristics which can significantly hinder the transferability of supply. Volvo / Renault<sup>133</sup> and Alcatel / Telettra<sup>134</sup> are two cases that illustrate this approach. In Volvo / Renault, the Commission stated that the market for public transport buses still maintained "for the time being the characteristics of a national market rather than a Community market,"<sup>135</sup> since strong national buying preferences and local specification requirements made it particularly difficult for competitors from other member states to compete. This was confirmed by the 69.7% and 64% market share that Renault and Volvo respectively had in France and in the United Kingdom. Both criteria also played a decisive role in Alcatel / Telettra, a concentration involving the acquisition by Alcatel NV of a controlling interest in Telettra SPA. The two companies were principally suppliers of telecommunications systems and equipment and competed for the supply of line transmission equipment in Spain, where Telefonica, the Spanish telecommunications operator, was by far the most important buyer. The Commission noted that "traditionally, in all Member States public networks were operated by State-owned telecommunication authorities which gave their orders . . . to a small group of national suppliers. This was often accompanied by specific national technical standards, which created adaptation costs for non-domestic suppliers."<sup>136</sup> It further pointed to different initiatives that have been taken in the framework of the achievement of the single market, and in particular to the Council Directive of public procurement<sup>137</sup> that is expected to break down the national-based buying policies of the telecommunications operators. However, this directive did not have to be implemented by member states until January 1, 1993 and even later implementation dates have been allowed for Spain (January 1, 1996), and Greece and Portugal (January 1, 1998). This explains the limited weight the Commission wanted to give

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<sup>133</sup> Volvo / Renault, *supra* note 51, at 17.

<sup>134</sup> Alcatel / Telettra, *supra* note 131, at 52-53.

<sup>135</sup> Volvo / Renault, *supra* note 51, at 17.

<sup>136</sup> Alcatel / Telettra, *supra* note 131, at 49.

<sup>137</sup> Council Directive (90/531/EEC) of 17 September 1990 on the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors, 1990 O.J. (L 297) 1.

to this future change in its assessment of the relevant geographic market.<sup>138</sup>

As to the cases involving firms that mainly do business with private customers, the Commission's analysis is always much more comprehensive, and decisions are based on a wide range of criteria. The so-called 'mail order' cases, *Otto / Grattan*<sup>139</sup> and *La Redoute / Empire*,<sup>140</sup> can serve as examples here. The product market affected in the two concentrations was the market for the retailing of non-food products through catalogue mail order. The Commission held this market to be national and it referred to at least three types of criteria. First, it cited a number of specific factors that rendered cross-border trading economically impractical, such as language differences, customs procedures (including VAT invoicing and payment), and costs and delays associated with the placing of international orders. It then stressed that consumer preferences significantly differed among member states, making it necessary for companies to foresee local facilities and separate catalogues with their own range of products and locally adapted pricing policies. Finally, the Commission has referred to the stage of development of the mail order market. In the United Kingdom, mail order is considered to be a mature, perhaps even declining market, while in Spain, Portugal and Italy, it is still a nascent business with prospects for growth. This analysis stands out by its consideration of both demand and supply-related barriers to interregional trade, which makes the Commission's conclusion as to the existence of national markets fully supportable.

A similar appreciation can be given for the Commission's approach in *ELF / BP / CEPESA*<sup>141</sup> and in *BP / Petromed*,<sup>142</sup> two very similar cases involving concentrations in the oil industry. The Commission first stated that it would confine its examination to the Spanish territory since

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<sup>138</sup> *Aérospatiale / MBB*, *supra* note 60, and *Tomson / Pilkington*, *supra* note 131, are two other cases that belong to this first sub-group. Both cases involved concentrations in the defence sector: one of the markets affected in *Aérospatiale / MBB* was the market for military helicopters and the *Tomson / Pilkington* decision involved a joint venture in the field of optronic defence systems. For all these products it was extremely exceptional that a country would give an order to a non-national supplier when national suppliers were available. Although the Commission indicated a tendency towards closer cooperation in the European defence industry, given the high costs of developing new defence equipment, it also noted that national governments still insist on the principle of "juste retour."

These 'military' cases clearly demonstrate the important weight the Commission is prepared to give to the national buying preferences, since this was the only factor that it referred to in order to define national markets.

<sup>139</sup> *Otto / Grattan*, *supra* note 59, at 11.

<sup>140</sup> *La Redoute / Empire*, *supra* note 59, at 12.

<sup>141</sup> *ELF / BP / CEPESA*, *supra* note 131, at 10-14.

<sup>142</sup> *BP / Petromed*, *supra* note 131, at 8-12.

both proposed concentrations would reinforce the parties' position only in this member state. It then made a distinction between the oil products which were subject to a state monopoly and those that were outside this monopoly. With regard to the former, it retained the Spanish insula and the Balearic Islands as the geographic reference market. The Commission based this definition both on the fact that only Spanish companies owned or operated refineries in the relevant territory, and on the existence of legislation that significantly impeded the establishment of a business and subjected imports to quantitative restrictions. It further referred to the then-approaching end of the 'transitional period' for the Spanish state monopoly,<sup>143</sup> but it added that this future change would only have a very limited effect in the short to medium term since new competitors would have to set up a complete distribution network, requiring heavy investments both in terms of time and money. The same geographic market definition also applied to the products which were not subject to the state monopoly, but here the Commission referred to other criteria. In particular, it pointed to the high transport/unit cost ratio of the products concerned, the importance of brands, the existence of import quotas and, finally, the absence of a well developed distribution network. It is again noteworthy that the Commission's analysis referred to demand as well as supply-related factors, even though the definition of Article 9 (7) of the Regulation primarily stresses the former and is as good as silent about the latter. As we have already indicated, we fully support this two-sided analysis of the relevant geographic market, since it is the best way to reflect the existence of possible barriers to interregional trade that may impede or even inhibit a competitor from reacting to a price rise in another geographic area.<sup>144</sup>

A third and final group of cases contains those decisions where the Commission has defined community-wide or even world markets. The

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<sup>143</sup> In the Act of Accession of Spain to the EC, it was provided that this period would lapse on January 1, 1992. Cf. *ELF / BP / CEPESA*, *supra* note 131, at 12; *BP / Petromed*, *supra* note 131, at 10.

<sup>144</sup> For more examples of cases where the Commission defined national markets, see the so-called 'battery cases,' *Mageti Marelli / CEAc*, *supra* note 62, and *Varta / Bosch*, *supra* note 63.

In both cases, the Commission stressed the existence of price differences among member states as well as significant disparities of the manufacturers' market shares in each member state. It attributed these differences to a wide range of causes such as product characteristics, consumer preferences for well known brands, distinct structure of the demand-side and, finally, the existence of highly concentrated markets, which made it more difficult for actual and potential competitors to increase their market shares or enter a market.

Although there were in both these cases enough indications to define national markets, we nevertheless regret that the Commission did not really scrutinize the supply-related barriers. In particular, the absence of any reference to the significance of transportation costs is remarkable, since this a factor that can strongly influence the importance of interregional trade barriers.

absence of significant price differences, the existence of homogeneous technical requirements and the presence of all major competitors in all three member states are the three main criteria that the Commission has used to arrive at its definition of the relevant geographic market in these cases. In some instances, it also referred to the presence of low transportation costs.

The ICI / Tioxide decision<sup>145</sup> can serve as an example of a case where the Commission found the relevant market to be community-wide. It held that the geographic market for titanium dioxide, one of the products affected by the proposed acquisition, was "at least the Community."<sup>146</sup> Leading to this conclusion were the existence of homogeneous technical requirements across the border, together with the absence of large price variations between member states. Equally important was the ability of several EC suppliers to have sales in countries where they had no production facilities. Lastly, the Commission indicated the significance of foreign imports of titanium dioxide in the EC. In 1989, 10% of the supply of titanium dioxide in the EC was imported. According to the Commission, this proved that the 6% import duty did not "seem to amount to a barrier."<sup>147</sup> Nevertheless, the Commission retained the EC as the relevant geographic market. In the resulting interpretation of the market shares, it took these foreign imports fully into account, however. It also mentioned the potential entrance on the EC markets of two U.S. manufacturers (including Du Pont, the world leader) and of one major Japanese manufacturer.<sup>148</sup>

In the important Aérospatiale-Alenia / de Havilland decision,<sup>149</sup> the Commission held the markets of regional turbo-prop aircrafts to be

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<sup>145</sup> ICI / Tioxide, *supra* note 50.

<sup>146</sup> *Id.*

<sup>147</sup> *Id.*

<sup>148</sup> Other examples of cases where the Commission defined community-wide markets are AT&T / NCR, *supra* note 122 (community-wide market for both personal computers and financial and retail workstations), VIAG / Continental Can, *supra* note 68 (EC market for closures, a conclusion mainly based on low transportation costs: since their packaging density is high, closures are easily transportable over long distances), Mannesmann / Boge, *supra* note 64 (community-wide market for shock absorbers both on the OEM/OES market and on the aftermarket. *See also supra* note 67), and Tetra Pak / Alfa-Laval, *supra* note 78 (EC market for all products involved). Ingersoll-Rand / Dresser, *supra* note 50 (EC market for industrial pumps); Alcatel / AEG Kabel, D. Comm. Dec. 18, 1991, 1992 O.J. (C 006) 23 (community-wide market for telecommunications calls and wires, overhead aluminum bare conductors and installation power cables and wires); Volvo / Atlas, D. Comm. Jan. 14, 1992, 1992 O.J. (C 017) 10 (EC market for hydraulic components); BTR / Pirelli, D. Comm. Aug. 17, 1992, 1992 O.J. (C 265) 5 (community wide market for automotive coolant hoses).

<sup>149</sup> Aérospatiale-Alenia / de Havilland, *supra* note 20. Metallgesellschaft / Safic-Alcam offers another example of a case where the Commission defined world markets, Metallgesellschaft / Safic-Alcam, D. Comm. Nov. 8, 1992, 1991 O.J. (C 300) 22 (world market for solid natural rubber).

world markets. The absence of any tangible barriers to the importation of these aircrafts into the Community and the negligible costs of transportation were two important factors that led to the Commission's conclusion. Equally influential was the presence of "a significant mutual penetration in particular between the markets of North America and Europe."<sup>150</sup> All major American and European competitors were indeed successfully competing on each other's continent and were present in the Asian-Pacific region as well. Since no such inter-penetration existed between the markets of China and the Eastern European countries and the overall world markets, the Commission accepted the parties' proposal to exclude these continents from the relevant geographic market. This conclusion was affirmed by different technical standards as well as large price differences of aircrafts in China and the eastern European countries, on the one hand, and the overall world markets, on the other. Finally, the Commission stated that "although in the long term it cannot be excluded that significant demand may emerge from eastern Europe for such products,"<sup>151</sup> this change would depend "on the general economic development of these countries"<sup>152</sup> and was therefore too speculative.<sup>153</sup>

Aérospatiale / MBB<sup>154</sup> is a second case where the Commission found a worldwide geographic market. In particular, it held that the civil helicopter market was "from an economic point of view a world market."<sup>155</sup> It therefore referred to the absence of barriers to market entry and to the mutual penetration of the markets between the EC, the USA and the rest of the world. We fully agree with this wide geographic market definition, but we are quite surprised by the next step in the Commission's reasoning. It stated: "The proposed concentration leads to a combined market share of about 50% for AS / MBB in the EC market for civil helicopters."<sup>156</sup> It seems quite contradictory to define first a worldwide geographic market and then calculate market shares in the EC market. Even if the Commission largely took the presence of world-

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<sup>150</sup> *Id.* at 47 (para. 20).

<sup>151</sup> *Id.*

<sup>152</sup> *Id.*

<sup>153</sup> It is probably not a coincidence that the Commission has waited for a case with a very wide relevant geographic market to declare a proposed concentration incompatible with the Common Market, thus insulating its decision from criticism that the geographic market is defined too narrowly.

As we will show in the second chapter, the merged company would not only obtain a very large market share, but also a leading position on the world market. A clearer example of the existence of market power or, to use the words of the Regulation, of the creation or strengthening of a dominant position is presumably hardly imaginable.

<sup>154</sup> Aérospatiale / MBB, *supra* note 60.

<sup>155</sup> *Id.* at 18.

<sup>156</sup> *Id.* at 19.



wide competition into account when evaluating the high market shares that the merged company would obtain, we nevertheless seriously question this evident inconsistency. Maybe the Commission experienced this contradiction itself, since it handled the same matter in a far more consistent way in the *Aérospatiale-Alenia / de Havilland* case. As indicated above, the Commission found the geographic market to be worldwide in that decision. It accepted however the consequences of this definition and calculated the market shares in the world market and not in the EC market, as it had done erroneously about 10 months before in *Aérospatiale / MBB*.

### 3. *Comparison With U.S. Law*

In the U.S. the definition of the relevant geographic market also has played a decisive role in several important merger cases.<sup>157</sup> The 1982 and 1984 Department of Justice Guidelines have brought about major changes in this area by providing a clear, structured approach towards an issue that has often been treated in a pragmatic, sometimes incoherent way. The general approach taken by the Guidelines toward geographic market definition is fundamentally similar to the one taken toward product market definition.

Beginning with the location of each merging firm or relevant plant, the Guidelines ask "what would happen if a hypothetical monopolist of the relevant product at that point imposed a 'small but significant and non-transitory'<sup>158</sup> increase in price."<sup>159</sup> If this price increase would be unprofitable, because too many buyers would "shift to products produced in other areas,"<sup>160</sup> then the Department of Justice will add the next best substitute and ask the same question again. This process will continue until the Department of Justice "identifies an area in which a hypothetical monopolist could profitably impose a 'small but significant and non-transitory' increase in price."<sup>161</sup>

The Guidelines recognize, however, the difficulty of determining directly the likely consequences of a future price increase. This explains

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<sup>157</sup> See, e.g., *United States v. Columbia Steel Co.*, 334 U.S. 495 (1948); *United States v. Bethlehem Steel Corp.*, 168 F. Supp. 576 (S.D.N.Y. 1958); *United States v. Philadelphia Natl. Bank*, 374 U.S. 321 (1963); *United States v. Pabst Brewing Co.*, 384 U.S. 546 (1966); *United States v. Connecticut Natl. Bank*, 362 F. Supp. 240 (D. Conn. 1973), *vacated and remanded*, 418 U.S. 656 (1974).

For a general overview of these cases as well as an appreciation of the geographic market definitions retained, see AREEDA & TURNER, *supra* note 41, 406-17.

<sup>158</sup> A 'small but significant and non-transitory' increase in price has the same meaning here as it does when defining the relevant product market. For comments and criticism, see, *supra* note 15.

<sup>159</sup> 1984 Merger Guidelines, *supra* note 12, at 26,829.

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

their reference to six factors to which the Department will give particular weight "in evaluating geographic substitutability."<sup>162</sup> Most of these criteria also play a decisive role in the Commission's approach toward geographic market definition, although there are some notable differences.

In particular, the Guidelines refer to the shipment patterns of both the merging firms and their competitors, to the willingness of buyers to shift their purchases to geographically dispersed sellers, and to price movements of the relevant product over a substantial period that are not due to changes in factors such as costs of inputs or income. These three criteria, which are mainly demand-related, likewise have a significant place in the Commission's decisions of the relevant market. Shipment patterns, for example, have had a decisive influence, at least in those cases where the Commission found community-wide or worldwide markets. Willingness of buyers to buy products or services from distant sellers, on the other hand, was a significant criteria in the Commission's analysis in both the second and the third group of cases distinguished above. Especially, it was the unwillingness of buyers — often public authorities — to buy products from non-domestic suppliers that made the Commission decide that the affected markets still maintained the characteristics of a national rather than a Community market.<sup>163</sup> Finally, price variations, as well as price similarities, were taken into account in many decisions when both national and EC or worldwide markets were defined.

The differences between the U.S. and the E.C. approach become more clear when examining the three following factors mentioned in the Guidelines, namely transportation costs, costs of local distribution and

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<sup>162</sup> *Id.* The 1992 Merger Guidelines seem to have made some important alterations here. Indeed, only one of the six factors mentioned in the 1984 Guidelines, namely, the willingness of buyers to shift their purchases to geographically dispersed sellers in response to relative changes in price or other competitive variables, has been explicitly retained. Other criteria, taken into account by the new Guidelines, are: "(2) evidence that sellers base business decisions on the prospect of buyer substitution between geographic locations in response to relative changes in price or other competitive variables; (3) the influence of downstream competition faced by buyers in their output markets; and (4) the timing and costs of switching suppliers." 1992 Merger Guidelines, *supra* note 13, at 20,573-3.

Again, we think it would be wrong to pretend that the criteria referred to in the 1984 Guidelines have lost all relevance. Transportation costs, costs of local distribution and the existence of excess capacity, for instance, are factors that will, at least to a certain extent, influence sellers' business decisions. However, this doesn't take away our impression that the influence of supply-related criteria in the definition of the relevant geographic market has somewhat lessened. Supply substitution factors are today considered when identifying the firms that participate in the relevant market as well as when evaluating the barriers of entry. See also 1992 Merger Guidelines, *supra* note 13, at 20,569.

<sup>163</sup> See, e.g., Volvo / Renault, *supra* note 51; Aérospatiale / MBB, *supra* note 60; Alcatel / Telettra, *supra* note 131; Thomson / Pilkington, *supra* note 131.

excess capacity of firms outside the location of the merging firms. These factors provide evidence of likely supply responses to hypothetical price increases. Indeed, the lower the transportation costs and the costs of local distribution, and the greater the excess capacity of firms in neighboring areas, the more likely it will be that distant firms will start importing into the local area in case of a price increase and, hence, the greater the likelihood that the market will include both areas. It is our impression that two of these three supply-related criteria, notably excess capacity and transportation costs, have received only a very limited weight in the Commission's decisions. In the more than eighty decisions we have analyzed, we have found hardly any reference to excess capacity, and transportation costs were mentioned in but a limited number of cases,<sup>164</sup> in which their influence moreover was rather small. Distribution costs, or, more generally, the difficulties of exporting products to distant areas, have, however, received considerable attention in a large number of cases.<sup>165</sup> This approach is not completely unexpected and no more without foundation. Indeed, according to a 1986 study prepared for the Commission,<sup>166</sup> transport costs are of less significance in the Community than legal, institutional and cultural barriers. This explains why the Commission has attached more importance to factors such as brand loyalties, linguistic and cultural differences, customs procedures and costs of local distribution. Distinct or homogeneous technical requirements — a factor that is not even mentioned in the Guidelines' list of relevant criteria — is still another criterion that has received large attention in most of the Commission's decisions. Although most of these criteria are prone to lead to narrow geographic market definitions,<sup>167</sup> we don't consider this as being problematic. As we have already indicated above, it is our opinion that, for many products and services, community-wide markets are not yet realized. Even if this is rapidly changing, a realistic approach remains required. We think that, at least in those cases where it has defined the relevant geographic markets, the Commission has taken such a realistic

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<sup>164</sup> See *Aérospatiale-Alenia / de Havilland*, *supra* note 20; *VIAG / Continental Can*, *supra* note 68 (this is the only case where transportation costs had a more decisive influence); *ELF / BC / CEP SA*, *supra* note 131; *BP / Petromed*, *supra* note 131.

<sup>165</sup> See, e.g., *Otto Versand / Grattan*, *supra* note 59; *La Redoute / Empire*, *supra* note 59; *ELF / BC / CEP SA*, *supra* note 131; *BP / Petromed*, *supra* note 131; *Magneti Marelli / CEAC*, *supra* note 62; *Varta / Bosch*, *supra* note 63.

See also most of the decisions belonging to the third group of cases, distinguished above. In these cases the Commission often highlighted the presence of firms in member states where they had no production facilities. This observation implies that the costs of local distribution were rather low.

<sup>166</sup> FRANCIS FISHWICK, DEFINITION OF THE RELEVANT MARKET IN COMMUNITY COMPETITION POLICY 55, 56 (1986) (document prepared for the Commission).

<sup>167</sup> James Venit, *supra* note 114, at 554.

approach. Nevertheless, this does not take away the need for more guidance. A list of criteria that are relevant for the definition of the geographic market, together with the weight the Commission is willing to give to each of them, would be more than welcome.

This comparison is concluded by again urging the Commission to issue 'market definition guidelines,' dealing not only with the issue of product market definition, but with geographic market definition as well.

## CHAPTER II: THE 'DOMINANT POSITION TEST'

### Introduction

Once the Commission has determined the relevant product and geographic markets as well as the firms active on these markets, the next step of its approach consists of computing the market shares of both the merging firms and their major competitors. This task is accomplished by setting the total sales of the merging firms (or of any of their competitors in which we are interested) in the defined market as the numerator and then dividing this figure by the larger denominator, consisting of the total dollar volume of sales in the defined market. The resulting percentage represents the market share of the merging firms.<sup>168</sup>

This market share will play a predominant role in the Commission's application of the substantive test of the Regulation, namely when deciding whether or not a dominant position is created or strengthened. However, this does not mean that there are no other criteria that the Commission will take into account before arriving at its final decision. What these criteria are and under what conditions a merger will "create or strengthen a dominant position,"<sup>169</sup> will be examined in the first section of this chapter. More generally, we will also look into the question of how the Commission defines 'dominant position' under the Merger Regulation and whether this definition differs from the one given in Article 86 cases.<sup>170</sup> Finally, we will focus on the issue of whether the Regulation

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<sup>168</sup> Cf. AREEDA & KAPLOW, *supra* note 27, at 572; POSNER, *supra* note 34, at 127; GELLHORN, *supra* note 31, at 106.

<sup>169</sup> Cf. Article 2(3) of the Regulation.

<sup>170</sup> Both Article 86 of the Treaty of Rome and Article 2 of the Merger Regulation refer to the notion of 'dominant position.' The context of these references is, however, fundamentally different. Cf. DOWNES & ELLISON, *supra* note 111, at 84-85.

While Article 86 only permits the Commission to intervene in case of an *abuse* of dominant position, Article 2 of the Regulation allows Commission intervention whenever a concentration with a community dimension "*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." Cf. Article 2(3) of the Regulation.

can or should also be applied to mergers that create, or further narrow, interdependent oligopolies.

In the second section, we will compare the Regulation's dominant position test and the so-called 'incipiency-test' of Section 7 of the Clayton Act. As we will show, it is with regard to these substantive tests, that the major differences between the U.S. and the E.C. approach towards mergers will be found.

### Section 1: Creating or Strengthening a Dominant Position

The approach taken by the Commission in assessing whether a proposed concentration leads to the creation or strengthening of a dominant position, is again rather pragmatic. When the combined market share of the merging firms is lower than or only equal to 25%, then the Commission's analysis of the affected markets and, in particular, of the strength of the remaining competitors and the structure of demand, will be very concise. However, this is not surprising since Recital 15 of the Regulation sets up a presumption of compatibility with the Common Market when the market share of the merging firms does not exceed 25%.<sup>171</sup>

The BP / Petromed decision<sup>172</sup> can serve as an illustration here. The Commission first stated that "the combined market share held by the merged entity will not attain 15% in any of the oil markets affected by the concentration."<sup>173</sup> It then briefly looked at the major competitors of the merging firms, REPSOL and CEPSA / ERTOIL, disposing of refining capacities that were respectively 6 and 3 times larger than Petromed's. The Commission concluded its analysis by holding that Petromed's acquisition by BP, a main international refiner, was "not likely to grant to Petromed a major advantage over its competitors,"<sup>174</sup> primarily since both REPSOL and CEPSA / ERTOIL were also controlled by major corporations, what conferred on them comparable competitive advantages. Consequently, no dominant position was created or strengthened by this proposed acquisition, and the concentration was declared compatible with the common market in application of Article 6(1)(b) of the Regulation.<sup>175</sup>

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<sup>171</sup> The full text of Recital 15 reads as follows:

Whereas concentrations which, by reason of the limited market share of the undertakings concerned, are not liable to impede effective competition may be presumed to be compatible with the common market; whereas, without prejudice to Articles 85 and 86 of the Treaty, an indication to this effect exists, in particular, where the market share of the undertakings concerned does not exceed 25% either in the common market or in a substantial part of it.

<sup>172</sup> BP / Petromed, *supra* note 131.

<sup>173</sup> *Id.* at 14.

<sup>174</sup> *Id.* at 16.

<sup>175</sup> For more examples of concise analyses of the affected markets, see, e.g., ICI / Tioxide, *supra*

On the other hand, the more the market share of the merged entity moves above the 25% threshold, the greater the Commission's readiness to take a closer look at the affected markets and to scrutinize each of the criteria mentioned in Article 2(1)(a) and (b) of the Regulation. These provisions direct the Commission to take into account "the structure of all the markets concerned and the actual or potential competition from undertakings located either within or without the Community"<sup>176</sup> and this in light of "the need to preserve and develop effective competition within the common market."<sup>177</sup> The Commission's competitive analysis should further focus on "the market position of the undertakings concerned and their economic and financial power, the opportunities available to suppliers and users, their access to supplies or markets, any legal or other barriers to entry, supply and demand trends for the relevant goods and services, the interests of the intermediate and ultimate consumers, and the development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition."<sup>178 179</sup>

It is not our goal to scrutinize separately all criteria mentioned in

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note 50, *Promodes / Dirs*, *supra* note 58, *Otto / Grattan*, *supra* note 62, *La Redoute / Empire*, *supra* note 59, *Conagra / Idea*, *supra* note 50, *ICL / Nokia Data*, *supra* note 120, and *Digital / Philips*, *supra* note 120. *Henkel / Nobel*, D. Comm. Mar. 23, 1992, 1992 O.J. (C 96) 23; *Bibby / Finanzauto*, D. Comm. June 29, 1992, 1992 O.J. (C 275) 8; *Volkswagen AG / V.A.G. (U.K.) Limited*, D. Comm. Feb. 4, 1993, 1993 O.J. (C 38) 12.

In all these cases, the combined market share of the new entity was only equal to, or lower than, 25%. Consequently, the Commission confined itself to underlining both the limited impact of this market share and the presence of competitors with comparable or higher shares. A similar justification was also used in those cases where the merged entity would become the market leader in some or all the markets affected by the merger. *See, e.g.*, *Promodes / Dirs*, *supra* note 58 (the new entity would become the number one retailer in both the intermediate and upper range of retail stores with market shares of respectively no more than 15% and 20%); *Digital / Philips*, *supra* note 120 (the new entity would become the market leader in the market of multi-user computers with a market share of no more than 18% on Community level).

<sup>176</sup> Article 2(1)(a) of the Regulation.

<sup>177</sup> *Id.*

<sup>178</sup> Article 2(1)(b) of the Regulation.

<sup>179</sup> Two more Recitals of the Regulation merit to be cited:

(1) Recital 13, the so-called 'Spanish' clause, which directs the Commission to "place its appraisal within the general framework of the achievement of the fundamental objectives referred to in Article 2 of the Treaty, including that of strengthening the Community's economic and social cohesion." For a discussion of the impact of this 'Spanish' clause, see *Venit*, *supra* note 167, at 524-27, and *Bernd Langeheine, Substantive Review Under the EEC Merger Regulation*, 1990 FORDHAM CORP. L. INST. 481, 497-500 (Barry Hawk ed., 1991).

(2) Recital 19 of the Regulation, urging the Commission to take into account the views of management and workers' representatives in the undertakings concerned, as well as the views of third parties showing a legitimate interest.

the Regulation.<sup>180</sup> This would indeed divert us from our initial focus, which is to examine how the Commission has applied the Regulation to 'real live' mergers. Nevertheless, two remarks remain to be made. First, it is important not to lose track of the fact that the whole Regulation, and, in particular, this list of substantive criteria, are the result of a compromise between the representatives of twelve member states, each having their own approach to merger control. The major difficulty faced by the Council of Ministers consisted, in particular, in resolving the differences between member states (such as France, Spain and Portugal) that favored application of industrial, regional and social policy considerations, and other member states (such as Germany and the United Kingdom) that favored merger control uniquely based on competition-related criteria. This underlying debate explains to a certain extent the somewhat ambiguous nature of Article 2(1)(a) and (b)'s list of substantive criteria, referring to both competition and non-competition factors.

For all that, it is generally agreed upon<sup>181</sup> that the impact of non-competition considerations in the Regulation's substantive test for the appraisal of mergers is very limited.<sup>182</sup> The two conditions that surround the reference to "technical and economic progress"<sup>183</sup> make this clear. Technical and economic progress may indeed only be taken into account when "it is to consumers' advantage and does not form an obstacle to competition."<sup>184</sup> Declarations of Sir Leon Brittan, the former EC Com-

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<sup>180</sup> For a general overview of this series of factors to be taken into account in the appraisal of a concentration, see DOWNES & ELLISON, *supra* note 111, at 90-96.

<sup>181</sup> See, e.g., Langeheine, *supra* note 179, at 500-02; Venit, *supra* note 114, at 522-23; EEC COMPETITION LAW, *supra* note 5, at 365-66; Eleanor M. Fox, *Merger Control in the EEC | Toward a European Merger Jurisprudence*, 1991 FORDHAM CORP. L. INST. 709, 714-18 (Barry Hawk ed., 1992); Burnside & Meyntjens, *supra* note 11, at 1391-92; Paul D. Callister, Note, *The December 1989 European Community Merger Control Regulation: a non-EC Perspective*, 24 CORNELL INT'L L.J. 97, 112-13 (1991), PIERRE BOS ET AL., *supra* note 5, at 228-229; CHRISTOPHER JONES & ENRIQUE GONZALEZ-DIAZ, *supra* notes 5, at 153-158. But see HAWK, *supra* note 32, at 922; Reynolds, *supra* note 116, at 720-21.

<sup>182</sup> Whether the concern for effective competition also prevailed in the Commission's analysis of mergers, is another issue that will be treated further on.

<sup>183</sup> Cf. Article 2(1)(b) of the Regulation. It is noteworthy that the term "technical and economic progress" was not invented by the drafters of the Regulation, but was already mentioned in Article 85(3) of the Rome Treaty as one of the reasons for exempting restrictive practices from the cartel prohibition.

<sup>184</sup> Cf. Article 2(1)(b) of the Regulation. These conditions were only added in the last draft of the Regulation. Indeed, Article 2 of the draft of November 1988, Amended proposal for a Council Regulation (EEC) on the control of concentrations between undertaking, 1989 O.J. (C 22) 4, foresaw the possibility of allowing certain mergers which were in fact incompatible with the Common Market when these mergers produced advantageous effects that outweighed their damage to competition. The replacement of this broad exception by two conditions, that significantly limit the impact of the concept of 'technical and economic progress' can already be regarded as a clear indication that the competition policy standard finally prevailed.

missioner responsible for competition, have made this point clear:

The technical and economic progress which a merger may bring about will certainly form part of the Commission's analysis of the reasons for a merger. However, this does not mean that such progress is a legitimate defence for a merger which creates a dominant position. In a competitive market, mergers may or may not give rise to technical and economic progress. In an uncompetitive market, even if they do, they will not be allowed. Indeed, in an uncompetitive market one would not expect to see technical and economic progress in the normal sense of those words at all. There may be some technical progress, but economic progress would be confined to the dominant company itself in the form of monopoly rents.<sup>185</sup>

Apart from the Commission's searching inquiry of the affected markets, there is still another characteristic that all the Commission decisions, in which the proposed concentration generates high market shares, have in common. In each of these cases, the Commission fully defines what should be understood by 'dominant position.'<sup>186</sup> The wording used by the Commission moreover is almost identical at times: it is the ability of the new entity "to act to an appreciable extent independently of its competitors, costumers and ultimately of its consumers,"<sup>187</sup> that characterizes a dominant position.

At first sight, this definition does differ somewhat from the one given by the Court of Justice in Article 86 cases. Indeed, in *United Brands*,<sup>188</sup> the Court defined a dominant position as "a position of economic strength enjoyed by the enterprise 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."<sup>189 190</sup> In the Court's definition, a dominant position is thus characterized by two elements, namely the power to prevent effective competition, and the power to be-

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<sup>185</sup> SIR LEON BRITTAN, *COMPETITION POLICY AND MERGER CONTROL IN THE SINGLE EUROPEAN MARKET* 35 (1991). See also *The Principles and Practice of Merger Policy in the European Community*, Address by the Right Honorable Sir Leon Brittan, Center for European Policy Studies, Brussels, September 24, 1990, Manuscript, at 2.

<sup>186</sup> See, e.g., *Renault / Volvo*, *supra* note 51, at 14; *Aérospatiale / MBB*, *supra* note 60, at 22; *Alcatel / Telettra*, *supra* note 131, at 54; *Mannesmann / Boge*, *supra* note 64, at 26; *Tetra Pak / Alfa-Laval*, *supra* note 78, at 42; *Varta / Bosch*, *supra* note 63, at 33; *Aérospatiale-Alenia / de Havilland*, *supra* note 20, at 56.

<sup>187</sup> Cf. *Tetra Pak / Alfa-Laval*, *supra* note 78, at 42.

<sup>188</sup> *United Brands v. Commission* (Case 27 / 76), 14 February 1978, [1978] E.C.R. 207, [1978] 1 C.M.L.R. 492, C.M.R. 8429.

<sup>189</sup> *United Brands v. Commission* (Case 27 / 76), *supra* note 188, para. 65.

<sup>190</sup> In all its judgments since *United Brands*, the Court has defined dominant position in the same way. Cf. VALENTINE KORAH, *AN INTRODUCTORY GUIDE TO EEC COMPETITION LAW AND PRACTICE* 64 (4th ed. 1990). See, e.g., the so-called *Vitamins case*, *Hoffmann-La Roche v. Commission*, 1979 E.C.R. 461, para. 38; CCH para 8527, in which the same definition is repeated word for word.



have independently. In the Commission's definition under the Merger Regulation, however, only the last component is retained.<sup>191</sup> Nevertheless, we do not think this difference is far-reaching. As Temple Lang suggests, the Court seems to regard the two components as two aspects of the same threshold.<sup>192</sup> In commenting on *United Brands*, he states that "[p]reventing effective competition" suggests power to indulge successfully in exclusionary practices; 'power to behave independently' suggests self-sufficiency and ability to implement a freely chosen strategy, to be a market leader in matters other than price . . . , and to lead to consumer preferences rather than being led by them."<sup>193</sup> This explanation seems plausible and is moreover fully reconcilable with the Commission's practice of withholding in merger cases only the second component of the dominant position definition given in *United Brands*. If 'preventing effective competition' actually means the power to engage successfully in exclusionary practices, then it seems to be above all a behavior-oriented component, characteristic of Article 86 offenses. As we have indicated above, Article 2 of the Merger Regulation is more structure-oriented. It merely tends to predict the effect of the merger on the structure of the market, in order to prevent the creation or reinforcement of a dominant position.

Yet another question remains. Even if we know what the Commission means by 'dominant position' in merger cases, it is still not clear what essential conditions have to be fulfilled before the new entity can be expected to be able 'to behave independently.' We will try to answer this question by looking into some of the most important cases the Commission has handled so far.

The first decision taken by the Commission can already be called remarkable. In *Renault / Volvo*,<sup>194</sup> the new entity would reach market shares of more than 50% in the truck markets in France and this for both the intermediate and the upper range of trucks. High market shares would also be obtained in Greece (more than 40% in each range of trucks), although there would be no addition through Renault here. At the EEC level, the combined market share of the merged companies would amount to 25% (24.5% in the intermediate range and 25.9% in

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<sup>191</sup> In only one decision, namely *Renault / Volvo*, *supra* note 51, which was the very first case decided under the Regulation, the Commission referred to both elements. Since then, no reference has been made to the power to prevent effective competition.

<sup>192</sup> John Temple Lang, *Abuse of Dominant Positions in European Community Law, Present and Future: Some Aspects*, in *INTERNATIONAL ANTITRUST; FIFTH ANNUAL FORDHAM CORPORATE LAW INSTITUTE*, at 34-35 (Barry Hawk ed., 1979).

<sup>193</sup> *Id.* at 35 n.9.

<sup>194</sup> *Renault / Volvo*, *supra* note 51.

the upper range). Despite these high market shares, the Commission concluded within one month<sup>195</sup> that no dominant position would be created or strengthened by the proposed concentration. To justify this conclusion, it referred to the presence of at least 5 other major competitors, which were likewise present in every EC country, where they had substantial distribution networks and held market shares that were "not insignificant."<sup>196</sup> The Commission also pointed out that the truck market was "performing in a highly competitive way both as regards innovation and prices."<sup>197</sup> Finally, its clearance decision was influenced by the buyers' tendency to become fleet buyers, moving toward a European purchasing policy and having the ability to exercise a considerable downward pressure on prices.<sup>198</sup>

The Renault / Volvo decision is surprising in two ways. First, it is remarkable that, despite the high market shares involved and the important competition questions that could have been considered, no proceed-

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<sup>195</sup> Article 10(1) of the Regulation states that "The decisions referred to in Article 6(1) must be taken within one month at most. That period shall begin on the day following the receipt of a notification or, if the information to be supplied with the notification is incomplete, on the day following the receipt of the complete information."

Article 6(1), in its turn, refers to three kinds of decisions the Commission can take: first, decisions of non-applicability of the Merger Regulation (since the notified concentration does not fall within the scope of the Regulation); second, clearance decisions (implying that there are no serious doubts about the compatibility of the concentration with the Common Market); third, decisions to open proceedings (implying that serious doubts exist about the compatibility with the Common Market).

See generally DOWNES & ELLISON, *supra* note 111, at 73-76; EEC COMPETITION LAW, *supra* note 5, at 14.

<sup>196</sup> Renault / Volvo, *supra* note 51, at 14. In France for instance, Mercedes had about 18% of the market in both the intermediate and upper range of trucks, and Iveco's market shares in the intermediate and upper range were respectively 22.2% and 11.9%. Taken together, this means that, once the merger was approved, the combined market shares of the three major competitors in France would amount to more than 90% in the intermediate range and more than 80% in the upper range of trucks.

<sup>197</sup> Renault / Volvo, *supra* note 51, at 14.

<sup>198</sup> The same justifications also applied to the coach market, since this market had "similar characteristics to the truck market" and did therefore "not need to be examined in any further detail." Renault / Volvo, *supra* note 51, at 16.

With regards to the bus market, the merged entity would obtain a very strong position in France (69.7% market share) and in the United Kingdom (64% market share). However, these market shares were not increased by the concentration since none of the two undertakings were present on the market of the other in these two countries. The Commission nevertheless took into account that Volvo and Renault were potential competitors of each other, particularly in light of the 1992 process when national markets would become increasingly open to foreign competitors. It stated, however, that "in such a case there remain several other major potential suppliers for buses . . . who could bring their power to bear on Renault and Volvo in these companies were to increase their price to a supracompetitive level." Renault / Volvo, *supra* note 51, at 18. Finally, the Commission also referred to the increasing influence of fleet buyers, that were moving towards a European purchasing policy.

ings were opened by the Commission. In part, this may have been due to the fact that Renault / Volvo was the first concentration notified under the Regulation and that the Commission was therefore anxious to prove that it could handle cases within the short time limits prescribed in the Regulation.<sup>199</sup> Nevertheless the absence of a fuller inquiry seems inconsistent with subsequent cases, such as the so-called 'battery cases'<sup>200</sup> or Alcatel / Telettra.<sup>201</sup> We do not think that the facts and market shares involved in these cases differed significantly from those in Renault / Volvo so as to justify such different treatment.

Second, Renault / Volvo is also noteworthy since it illustrates the approach taken by the Commission in cases involving high market shares. Indeed, in most of these cases, the Commission underlines the presence of other major competitors, which it expects to produce a sufficient counterweight to the newly merged entity, so that the latter is prevented from behaving, to an appreciable extent, independently of its competitors and, thus, effective competition can be maintained. However, as Professor Fox rightly remarks: "... the fact that other important competitors *can* still wage effective competition does not mean that they have an *incentive* to do so."<sup>202</sup> Where only a limited number of firms remain on the market, the development of oligopolistic structures is not unlikely. In such circumstances, undertakings may consciously or unconsciously follow the price of their few competitors, a situation that can quickly result in both higher prices for the consumer and restricted innovation and progress.<sup>203</sup> Even if the Commission's statement in Renault / Volvo that the truck market was performing in a highly competitive way, somewhat undercuts the hypothesis of oligopolistic behavior, it remains that, for a long time,<sup>204</sup> the latter problem has hardly received any attention in the Commission's merger analysis. This is curious, since both commentators<sup>205</sup> and Commission officials<sup>206</sup> have defended the position

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<sup>199</sup> Reynolds, *supra* note 116, at 722.

<sup>200</sup> Magneti-Marelli / CEAC, *supra* note 62; Varta / Bosch, *supra* note 63.

<sup>201</sup> Alcatel / Telettra, *supra* note 131.

<sup>202</sup> Fox, *supra* note 181, at 764.

<sup>203</sup> On the dangers of oligopolistic behavior, see generally AREEDA & KAPLOW, *supra* note 27, at 18-19, 277-83.

<sup>204</sup> The Nestle / Perrier decision, *supra* note 19, changed this decision.

<sup>205</sup> See, e.g., Venit, *supra* note 114, at 531-44; Jeremy Lever, *Substantive Review under the Merger Regulation: A Private Perspective*, 1990 FORDHAM CORP. L. INST. 503 (Barry Hawk ed., 1991) and CHRISTOPHER JONES & ENRIQUE GONZALEZ-DIAZ, *supra* note 5, at 168-172. They stress the importance of the matter. "This question is not simply of theoretical importance. EC markets are moving from national to community in scope, and cross border mergers and acquisitions are rapidly concentrating industry when measured at the community levels. This trend will continue, and the question must be asked whether one wishes to see community markets having the medium to long term perspective of oligopolistic structure. Without a community-wide merger control that covers

that the Regulation can and should be applied not only to single-firm dominance, but also to oligopolistic dominance. As we will demonstrate in the second section of this chapter, it is the absence during nearly two years, of almost any reference to oligopolistic behavior in the Commission's decisions that constituted the major difference from the approach taken in the U.S. under Section 7 of the Clayton Act.

Another interesting case, involving very high market shares, but that was nevertheless cleared within one month without a full investigation, is the *Aérospatiale / MBB* decision,<sup>207</sup> involving the merger of the helicopter facilities of the French state-owned company *Aérospatiale* and the German company *Messerschmitt-Bölkow-Blohm* (MBB). With regard to military helicopters, both undertakings already held complete monopolies in their home countries.<sup>208</sup> Although *Aérospatiale* and MBB thus held a dominant position in their home markets, the Commission argued that the proposed merger would not strengthen these dominant positions "because, given the particular conditions of the defense industry, AS and MBB (we)re neither actual nor — at least for the foreseeable future — potential competitors in the markets concerned."<sup>209</sup> This state-

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oligopolistic dominance, this threat is a real one, and is likely to be particularly pronounced in relation to consumer goods and traditional manufactured products (such as batteries) where markets are mature." JONES & GONZALEZ-DIAZ, *supra* note 5, at 172.

<sup>206</sup> A 1986 study on the concept of shared dominance and its relevance to competition policy, that was undertaken at the Commission's demand, concluded that the two essential features of shared dominance were:

- (i) a concentrated market in which a small number of enterprises account for most of the turnover without any single enterprise holding a dominant position; and
- (ii) a high degree of interdependence as concerns the decision-making processes of these enterprises.

See E. KANTZENBACH & J. KRUSE, *KOLLEKTIVE MARKTBEHERRSCHUNG: DAS KONZEPT UND SEINE ANWENDBARKEIT FÜR DIE WETTBEWERBSPOLITIK* (1987).

In commenting on this study, the Commission stated that one of the primary objectives behind the then-proposed merger regulation was to prevent the creation of situations that would result in stable collusion between oligopolists. See Commission, Sixteenth Report on Competition Policy, at ¶¶ 331-334 (1987).

Finally, in a speech given in Brussels on October 28, 1991, Sir Leon Brittan underlined that, in his view, the concept of dominant position within the Merger Regulation also covers oligopolistic dominance. He argued that where a merger or acquisition creates or reinforces a market structure on which price collusion or price parallelism between undertakings becomes highly likely, this concentration should be held incompatible with the common market. A limited number of large players on a mature market with high entry barriers would characterize a market structure on which oligopolistic behavior was likely. Finally, he added that it would probably be a 'question of time' before the first such cases arise. Once the 1992 process would create truly integrated markets, he expected the control of oligopolies to play a central role in the Commission's merger policy. Cf. Brittan Reflects on First Year of Merger Control, 694 C.M.R. 1, at 14, November 14, 1991.

<sup>207</sup> *Aérospatiale / MBB*, *supra* note 60.

<sup>208</sup> The same was true for Augusta and Westland, the two other helicopter producers in the EC, that each held a 100% market share in, respectively, Italy and the United Kingdom.

<sup>209</sup> *Aérospatiale / MBB*, *supra* note 60, at 13.

ment calls for two remarks. First, one can wonder whether the two companies involved are really unlikely to become potential competitors. Indeed, the fact that both France and Germany agree to a merger of their national supplier with a non-national renders doubtful the claim that only a domestic supplier will do.<sup>210</sup> Second, and more important, is the decrease of the number of military helicopter producers within the EC from four to three. This evolution will make it less likely for competition to break out and can therefore be held to increase market power. Indeed, after the merger, neither France nor Germany, nor any of the EC countries that do not have national helicopter suppliers, will be able to play Aérospatiale and MBB off against one another.<sup>211</sup>

In the civil helicopter market, the combined market share of the new entity would amount to 52% of the EC market. However, since the civil helicopter market was "from an economic point of view a world market,"<sup>212</sup> the Commission largely took into account the impact of actual and future competition of U.S. manufacturers. In this respect, it referred to the parties' claim that, due to a tightening of the military budget in the U.S., their American competitors could be expected to increase their activities in the civil helicopter market. However, given the Commission's own statement that the civil helicopter business largely depends on support coming from the market in military helicopters, it is at least questionable that the U.S. civil helicopters will really become more competitive once the military subsidy is largely withdrawn.<sup>213</sup> The Commission referred briefly to the two remaining European competitors, Augusta and Westland. It argued that the proposed merger would not "foreclose their access to technical cooperation and European development programmes [sic] which are essential for their competitiveness,"<sup>214</sup> since AS and MBB had declared that they would remain open to such kind of cooperation. Finally, the Commission emphasized that the increased concentration that the merger would bring about on the civil helicopter market, would be only marginal.<sup>215</sup> Only in Germany would there be a significant change in concentration (MBB held a market share of 22% there), but the market was small and the U.S. presence great. Therefore, no harm to competition could be foreseen and, consequently, the merger was cleared.

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<sup>210</sup> Fox, *supra* note 181, at 759.

<sup>211</sup> *Id.*

<sup>212</sup> Aérospatiale / MBB, *supra* note 60, at 18.

<sup>213</sup> See also Fox, *supra* note 181, at 760; Reynolds, *supra* note 116, at 722-23.

<sup>214</sup> Aérospatiale / MBB, *supra* note 60, at 23.

<sup>215</sup> The 8% market share of MBB represented only a marginal amount of 10 million Ecu, or 5 helicopters a year.

While these first two cases might still leave us with some doubts as to whether industrial policy concerns, rather than competition policy considerations, have exercised a decisive influence on the Commission's final conclusion,<sup>216</sup> it remains fair to say that, in most of the other cases decided so far, the criteria which have been applied seem to be predominantly competition-based. Moreover, at various instances, the Commission has proven its ability to examine in detail the effects of the proposed concentration on the affected markets.

The concentration examined in Fiat Geotech / Ford New Holland,<sup>217</sup> for instance, would make the new entity the market leader in both the tractor and the combine harvester market with market shares on the Community level of, respectively, 24.6% and 34%. After having referred to the complementarity of the merging companies,<sup>218</sup> as well as to the strength of the remaining competitors, the Commission underlined the considerable decline in Fiat's sales and market shares since 1985, together with the shrinking nature of the relevant product markets. As a consequence of this, producers started rationalizing production and looked for "other means to deal with problems of overcapacity, including strengthening their dealer networks in areas where they are currently weak in order to increase their market share in these areas."<sup>219</sup> Finally, the Commission stated that it was well aware of the increased level of concentration on the combine harvester market.<sup>220</sup> Therefore, "very close scrutiny of any further additional mergers on this market"<sup>221</sup> would be needed. We fully support the Commission in adopting a dynamic interpretation of the obtained market shares as well as in its recognition of the highly concentrated nature of the combine harvester market. As already indicated above, this reference to the level of concentration is one of the considerations that, for a long time have received only limited attention in the Commission's analysis. We encourage the Commission to consistently examine this issue in its future decisions, just as it has done in Fiat Geotech / Ford New Holland.

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<sup>216</sup> See also Reynolds, *supra* note 116, at 729. It is arguable that Nestle / Perrier, *supra* note 19, and Air France / Sabena, D. Comm. Oct. 5, 1992, 1992 O.J. (C272) 5, offer two more examples of Commission decisions that have, at least in part, been influenced by industrial policy concerns.

<sup>217</sup> Fiat Geotech / Ford New Holland, *supra* note 59.

<sup>218</sup> Fiat was mainly active in Italy, Spain and France, while Ford New Holland was stronger in the United Kingdom, Denmark and Ireland. Moreover, each undertaking was active in different product ranges.

<sup>219</sup> Fiat Geotech / Ford New Holland, *supra* note 59, at 23.

<sup>220</sup> Apart from the new group, only four competitors would be left: Claas with less than 30%, John Deere with less than 20%, and KHD and Case with less than 10%.

<sup>221</sup> Fiat Geotech / Ford New Holland, *supra* note 59, at 23.

Alcatel / Telettra<sup>222</sup> is the first case that the Commission has decided after opening the full proceedings. This decision to open full proceedings was not really surprising since the combined market share of Alcatel and Telettra on the Spanish transmission market accounted to more than 80%.<sup>223</sup> Despite these impressive market shares, the Commission nevertheless concluded that the proposed concentration would not create or strengthen a dominant position.

Three considerations seem to have influenced this outcome. First, the Commission emphasized the predominant buying power of Telefonica, the Spanish telecommunications operator, as well as its preexisting purchasing policy to diversify. Given this policy, the Commission held it improbable that the new entity would sustain as large a combined market share as was achieved by the parties as competitors. A second factor, that countered the inference of a dominant position, was the capability of AT&T and Ericsson, the two principal actual competitors on the Spanish transmission markets, to immediately increase their production. In the same context, the Commission referred to the prospect of potential entry by strong European-based competitors such as Siemens, that would not face considerable technical barriers of entry. Telefonica's statements that it was willing to provide such potential suppliers — including those without industrial presence in Spain — with any information that would be necessary in order to enable them to compete on an equal footing, also had a significant influence here. A third and final problem was Telefonica's participation in the capital of Alcatel and Telettra.<sup>224</sup> The Commission considered this participation to amount to a barrier for other competitors. However, it solved this problem by applying, for the first time, Article 8 (2) of the Regulation.<sup>225</sup> As a condition to the approval of the concentration, the Commission required Alcatel to buy the shares held by Telefonica in both Telettra Espana and Alcatel Standard Electrica S.A.

For different reasons, Alcatel / Telettra is a remarkable case. First, the Commission has pointed out the important role that Article 8(2) of the Regulation can play in its approval of mergers. Indeed, it seems unlikely that the proposed concentration would have been allowed without these conditions and without the statements of Telefonica as to its

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<sup>222</sup> Alcatel / Telettra, *supra* note 131.

<sup>223</sup> In the market for line transmission equipment, the two undertakings would hold a combined market share of 81% (Alcatel 40%, Telettra 41%) and in the market for microwave equipment, their market share would amount to 83% (Alcatel 18%, Telettra 65%).

<sup>224</sup> Telefonica held 10% of Telettra Espana and 21% of Alcatel Standard Electrica S.A.

<sup>225</sup> See, *supra* note 19.

purchasing policies.<sup>226</sup> Second, the Commission also made clear that, in cases involving high market shares, almost all criteria of Article 2(1)(a) and (b) receive a place in its analysis. Both the structure of the affected market and actual as well as potential competition received ample attention. The market position of Alcatel and Telettra, and their financial structure were also examined. Finally, the Commission took the existence of technical and structural barriers into account and also looked into the consequences of the proposed concentration for both suppliers and users. And third, Alcatel / Telettra indicates that, even if the Commission rarely refers to substitutability of supply when defining the relevant product and geographic markets, this factor nevertheless can have a decisive influence in its subsequent analysis of the resulting market shares. The investigation into the presence of excess capacity within AT&T and Ericsson, as well as the inquiry into technical and structural barriers that could impede the entrance of potential competitors on the market, have made this point clear.

The 'twin cases,' Magneti Marelli / CEAc<sup>227</sup> and Varta / Bosch<sup>228</sup> are two more examples of cases that have only been decided after full proceedings had been opened.

In Magneti Marelli / CEAc, the Commission focused on the consequences of the proposed concentration for the French market. It held that the new entity would acquire a dominant position in this market with a market share of about 60%, while a considerable gap (on the order of 40%) would separate it from the next largest competitor.<sup>229</sup> Moreover, the new entity would distinguish itself from its competitors by its financial strength and that of its parents, as well as by its better access to the lead market. Finally, the dominant position could not be counter-balanced by the strength of purchasers.

The Commission, however, did not prohibit the merger, since Fiat, Magneti Marelli's parent company had independently decided to reduce its shareholding in CFEC, Magneti Marelli's French subsidiary, to 10% and agreed not to increase this holding again without the Commission's consent. This decision constituted an important change in the facts of the concentration. Indeed, at the time of its acquisition by Magneti Marelli in 1990, CFEC (Compagnie Francaise d'Electrochimie), was the second largest French battery manufacturer and accounted for virtually all of Magneti Marelli's 18.4% market share in France. Consequently, the

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<sup>226</sup> See Reynolds, *supra* note 116, at 724.

<sup>227</sup> Magneti Marelli / CEAc, *supra* note 62.

<sup>228</sup> Varta / Bosch, *supra* note 63.

<sup>229</sup> Magneti Marelli / CEAc, *supra* note 62, at 40 (para. 16).



Commission declared the proposed concentration compatible with the Common Market, subject, however, to the condition that Fiat would comply with the decision it had independently taken.

The Varta / Bosch case concerned a concentrative joint venture between Varta and Bosch in the starter battery market. In a Statement of Objections, drafted after a broad investigation into the matter,<sup>230</sup> the Commission stated that the proposed concentration would result in a dominant position for Varta / Bosch on the replacement market for batteries in both Germany and Spain. The dominant position on the German market was mainly caused by the high combined market share of the new entity (44.3%) as well as by its large lead (>25%) over most competitors. These competitors were generally small and medium-sized battery specialists, with little or no excess capacity and with limited financial strength in comparison with Varta / Bosch. Finally, the other large European producers had only a limited influence on the German market.<sup>231</sup> As regards the dominance of the new entity on the Spanish market, this was explained by a large market share (44.5%), combined with the presence of an equally strong competitor, that could lead "to alignment of the behavior of both competitors."<sup>232</sup> Moreover the Commission noted the absence of any other large actual competitor that would be able to counter such alignment.

We fully support the Commission's evident concerns for oligopolistic behavior on the Spanish market. However, either these concerns were only of short duration or the Commission is easy to convince in oral meetings. Indeed, in the next paragraph of its decision, it stated: "Following the Statement of Objections an oral meeting of the parties was held. As a result the Commission maintained its objections as to the German market."<sup>233</sup> It is completely unclear what influenced the Commission to change its realistic and pertinent fears of collective dominance on the Spanish market.

As to the dominant position in Germany, the Commission likewise changed its mind, but only after both substantive commitments had been entered into by Varta, and certain factual changes had occurred on the German battery market. Varta namely agreed to terminate its licence agreement with Deta / Mareg, its strongest competitor on the German replacement market for starter batteries.<sup>234</sup> It also agreed to end any

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<sup>230</sup> Varta / Bosch, *supra* note 63, at 27 (para. 10).

<sup>231</sup> *Id.* at 30 (para. 32).

<sup>232</sup> *Id.*

<sup>233</sup> *Id.* at 30 (para. 32).

<sup>234</sup> Deta / Mareg had a market share of over 10% on the German market, but was not considered

overlapping membership of the supervisory boards of Varta and Deta / Mareg. These modifications would make Deta / Mareg a significant independent player in the near future on the German market, the Commission argued. The factual changes on the German battery market, on the other hand, concerned the acquisition by Fiat / Magneti Marelli of the German battery supplier Sonnenschein.<sup>235</sup> The Commission found that this acquisition would significantly change the structural market conditions. Due to the acquisition, Fiat's market share in Germany would increase from 1% to more than 10%, and, more importantly, Fiat's competitive potential would substantially change.<sup>236</sup> These two changes, the dissolution of the cooperative relationship between Varta and Deta / Mareg, and the increase of the market potential of Fiat, sufficed for the Commission to review the conclusions drawn in the Statement of Objections. It declared the proposed concentration compatible with the Common Market, not without imposing on Varta, however, the obligations described above.

In addition to the way in which the Commission defined the relevant product and geographic markets, the 'battery cases' have other important characteristics in common. In both decisions, the Commission first found the existence of a dominant position, but later changed its mind, by taking into account (or 'by imposing'?<sup>237</sup>) factual changes in the proposed deals and by referring to modifications on the structure of the market affected. Both cases are particularly interesting since they give a clear view of some aspects of the Commission's general approach towards mergers. First, they illustrate again the particular strength of Article 8 (2) of the Regulation, allowing the Commission to attach conditions to its approval of a concentration. This provision has given the Commission substantial flexibility in its assessment of mergers and it has proven more than helpful in almost every major case. Second, the 'twin cases' also

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as an authentic independent competitor to the new entity, given its comprehensive cooperative links with Varta. Cf. Varta / Bosch, *supra* note 63, at 33 (para. 58).

<sup>235</sup> This acquisition would take place via CEAc, the French battery producer that had been acquired before by Fiat / Magneti Marelli. Cf. Varta / Bosch, *supra* note 63, at 30 (para. 34).

<sup>236</sup> The Commission stated that "the concentration of Fiat, CEAc and Sonnenschein would "create substantial synergy effects," which give "rise to the expectation that the competitive potential of the new entity will be more important than the current market shares achieved through the merger might indicate." Cf. Varta / Bosch, *supra* note 63, at 32 (para. 50).

In particular, the Commission emphasized Fiat's access to a well known German brand as well as to all its distribution channels. Moreover, it underlined both Fiat's financial strength and the presence of its spare capacity. It concluded by holding that "due to the merger of Fiat / CEAc / Sonnenschein, a strong competitor will emerge whose competitive potential will be significantly larger than the sum of the separate potential of each of the companies before the merger." Cf. Varta / Bosch, *supra* note 63, at 32 (para. 50).

<sup>237</sup> See Winterscheid, *supra* note 89, at 33.

underline the Commission's hospitable attitude towards mergers. It seems to us that, whenever there is doubt as to the compatibility or incompatibility of a proposed concentration with the common market, the Commission will always be inclined to the former, certainly when national geographic markets have been defined. Third, Varta / Bosch is interesting, since it proved that the Commission does not feel strictly bound by the opinion expressed by the Advisory Committee on Concentrations.<sup>238</sup> Although the majority of the Advisory Committee was of the opinion "that the factual changes were insufficient to alter the appraisal given in the Statement of Objections,"<sup>239</sup> the Commission nevertheless cleared the merger.

Nestlé / Perrier<sup>240</sup> offers another example of a case that has only been decided after opening full proceedings. Given the high market shares involved,<sup>241</sup> the decision to open full proceedings was not really surprising. More surprising and more important for future decisions, is the Commission's explicit reference to oligopolistic dominance when as-

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<sup>238</sup> Article 19 (3) of the Regulation provides for the creation of an "Advisory Committee on Concentrations." This Committee consists of one or two representatives of each member state and must be consulted whenever the Commission has decided to open full proceedings. Consultation is also required before the Commission may decide to impose fines or periodic penalty payments, in application of Articles 14 and 15 of the Regulation. Although the Committee's advice is not legally binding for the Commission, Article 19 (6) nevertheless states that "the Commission shall take the utmost account of the opinion delivered by the Committee. It shall inform the Committee of the matter in which its opinion has been taken into account." See generally Article 19 of the Regulation; Downes & Ellison, *supra* note 111, at 125-26.

<sup>239</sup> Varta / Bosch, *supra* note 63, at 31 (para. 36).

<sup>240</sup> Nestlé / Perrier, *supra* note 19. Nestlé is a publicly held Swiss company, which is active in many sectors of nutrition. After a public bid, it acquired the majority of the shares in Perrier, a French company which is mainly active in the manufacture and distribution of bottled waters. The notified concentration primarily affected the business of bottling water originating from natural springs or sources.

<sup>241</sup> Already before the merger, the French market for bottled source waters, which was retained as the relevant market, was highly concentrated with three suppliers holding 82% of the market by value and nearly 75% by volume. In the market of mineral waters, the three suppliers together held over 90%. It is clear that the proposed merger would further increase this concentration since the same market shares would now be held by two instead of three suppliers. See Nestlé / Perrier, *supra* note 19, at 356/13.

It is noteworthy that the Commission adopted a progressive, economic approach, taking into account both demand and supply considerations when defining the relevant product and geographic market.

The Commission thus examined the cross-elasticity of demand between bottled source waters and soft drinks. It concluded this cross-elasticity to be low since it could not "be reasonably expected that a appreciable, non-transitory increase in the price of source waters, would lead to a significant shift of demand from source waters to soft drinks for reasons of price only." Nestlé / Perrier, *supra* note 19, at 356/4. Considerations of supply-side substitutability could not alter the demand-side based conclusion, that bottle source waters should be considered as the relevant product market. The Commission underlined that the presence of production and marketing constraints made it "impossible for soft drink or beer producers to switch their installed capacity from produc-

sessing the notified concentration's compatibility with the Common Market.

The Commission began its examination with the calculation of the market shares of the three main water suppliers on the French market (Nestlé, Perrier and BSN).<sup>242</sup> This calculation led to the preliminary conclusion that the proposed merger "would further increase" concentration in an already "highly concentrated market."<sup>243</sup>

It then examined a number of factors that might lead to a downward adjustment of the obtained market shares, such as the presence of capacity reserves, the existing price gap and price parallelism between local spring waters and national mineral waters, and competition constraints from local water suppliers. The Commission also took a look at the buying power of big retailers and at potential competitors. None of these factors could however change the Commission's preliminary conclusion. On the contrary, the inquiry clearly showed that, even before the proposed merger, "a narrow oligopoly of three suppliers" existed, among whom price competition was considerably weakened and for whom the degree of market transparency was very high.<sup>244</sup> The Commission correspondingly restated its preliminary conclusion as follows: "the proposed merger . . . ) would create a duopolistic dominant position which would significantly impede effective competition on the French bottled water market."<sup>245</sup>

Finally, one remaining question had to be answered, namely whether Article 2(3) of the Regulation covers situations of oligopolistic or duopolistic dominance. The Commission took the view that Article 2 did cover these situations. It explained its position by arguing that "the distinction between single firm dominance and oligopolistic dominance cannot be decisive for the application or non-application of the Merger Regulation because both situations may significantly impede effect com-

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tion of soft drinks to production of source water, be it spring or mineral water." Nestlé / Perrier, *supra* note 19, at 356/6.

A similar approach of balancing demand and supply factors was adopted in defining the relevant geographic market. "In view of the different competitive environment prevailing in each Member State, the practical impossibility of the development of parallel imports and the absence of community competitors capable of overcoming the strong barriers to entry into the French market", the Commission held the relevant geographic market to be France. Nestlé / Perrier, *supra* note 19, at 356/6.

<sup>242</sup> See *supra* note 241.

<sup>243</sup> Nestlé / Perrier, *supra* note 19, at 256/13.

<sup>244</sup> *Id.* at 356/14. The Commission also stated that, before the merger, prices for national mineral waters were "probably already at a very high, supra-competitive price level" and that "whoever first increased its prices was always followed by the other two suppliers". See Nestlé / Perrier, *supra* note 19, at 356/14 - 15.

<sup>245</sup> *Id.* at 356/23.

petition under certain market structure conditions. This is in particular the case if there is already weakened competition before the merger between the oligopolists which is likely to be further weakened by a significant increase in concentration and if there is not sufficient price-constraining competition from actual or potential competition coming from outside the oligopoly."<sup>246</sup>

It was clear that without commitments by Nestlé, the proposed concentration would be declared incompatible with the common market, a situation that would put Nestlé in an uncomfortable position, since it only took control of Perrier after a long and costly takeover battle. Pursuant to Article 8(4), a prohibition of the merger would oblige Nestlé to divest all assets and interests in Perrier. It is hardly surprising that Nestlé offered to modify the original concentration plan by proposing to sell three million liters of water capacity per annum and a portfolio of brands to a purchaser having both, sufficient financial resources and sufficient expertise to become a viable competitor of Nestlé and BSN.<sup>247</sup> The proposal was sufficiently far-reaching to convince the Commission to change its mind and approve the modified concentration. On the one hand, this change of mind was not unexpected. At various times, the Commission has proven both its flexible attitude towards mergers and its willingness to approve a notified concentration subject to conditions, that have often been proposed by the notifying parties. On the other hand, the Commission has been too lenient in this case. At various times, the high level of concentration as well as the presence of oligopolistic behavior and of super-competitive pricing, has been indicated before the merger. Even with the proposed sale of both capacity and brand names, the level of concentration and consequently the probability of super-competitive pricing will significantly increase. Therefore, it may be argued that the approval is the result of a political compromise between the different member states. The proposed merger was approved, but at the same time, the Commission clearly stated that oligopolistic dominance is also covered by the Regulation. This statement made Nestlé / Perrier a landmark case in the Commission's practice of reviewing large mergers.<sup>248</sup>

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<sup>246</sup> *Id.* at 356/24.

<sup>247</sup> The deal included some other commitments. Nestlé thus agreed to hold separate from its own operations, all assets and interests acquired from Perrier, until completion of the proposed sale to a single entity, approved by the Commission. It also enjoined and restrained itself from reacquiring, directly and indirectly, any of the sources or brands which it would divest, for a period of 10 years from the date of the approval decision. See Nestlé / Perrier, *supra* note 19, at 256/29 -30.

<sup>248</sup> A certain reservation nevertheless has to be made, since on February 3, 1993 employees of Pierval and Vittel, two of the springs and trademarks that had to be sold by Nestlé, brought an

Most of the cases that we have dealt with so far, can be called "border-line cases." However, in all of them, the Commission has cleared the proposed transaction, sometimes subject to certain conditions. One can wonder what characteristics a proposed concentration should have in order to be held incompatible with the common market. Up to now, only one decision may answer that question, namely the *Aérospatiale-Alenia / de Havilland* case.<sup>249</sup>

As indicated above, this case concerned the proposed joint acquisition by *Aérospatiale* and *Alenia* of the *de Havilland* division from *Boeing*. The Commission argued that the regional turbo-prop aircraft market could be divided into three categories by numbers of seats (20-39, 40-59 and 60 plus) and it held the world market to be the relevant geographic market. On the basis of these definitions, the Commission found that, in the "market of 40 to 59 seats, the new entity would obtain about 64% of the world market and about 72% in the Community."<sup>250</sup> Even higher market shares would be obtained in the market of 60 seats and above.<sup>251</sup> Finally, in the overall commuter market, the new entity would have, worldwide, a share of 50% and on the Community level, a share of about 65%.

In assessing the impact of the proposed concentration, the Commission first examined the effect on *ATR's* position.<sup>252</sup> In particular, it stressed the impressive nature of the obtained market shares and underlined the significant increase in market shares the proposed acquisition would lead to. The Commission further took into account that the acquisition, if approved, would eliminate *de Havilland* both as an actual competitor in the market of 40 to 59 seats, and as a potential competitor in

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action against the Commission before the European Court of First Instance. They are claiming that the Commission infringed the Regulation by applying Articles 2 and 3 to a situation of oligopolistic dominance. Furthermore, they argue that some of the conditions imposed by the Commission are impossible to fulfill. In particular, they state that the transfer of two springs, *Thonon* and *Vichy*, is not possible since they do not form part of the assets of *Perrier* and consequently of *Nestlé*. See 1993 O.J. (C 70) 12-13.

In this regard, the President of the EC Court of First Instance asked, on April 21, 1993, the Commission for further information concerning the feasibility of the *Nestlé / Perrier* merger. The President noted that apparently "implementation of all the conditions to which the decision [*Nestlé / Perrier* decision] subjected authorisation of the merger still depends on approval by bodies not involved in the present litigation, namely the French State and the City of *Thonon-les-Bains*." See *Europe*, April 22, 1993, p. 9.

<sup>249</sup> *Aérospatiale-Alenia / de Havilland*, *supra* note 20.

<sup>250</sup> *Aérospatiale - Alenia / de Havilland*, *supra* note 20 (para. 26).

<sup>251</sup> In this market, the new entity would have 76% of the world market and 74% in the Community.

<sup>252</sup> It is under the name *ATR* (*Avions de Transport Régional*) that *Aérospatiale* and *Alenia* jointly manufacture and sell regional transport aircraft. See also, *supra* note 72.

the segment of 60 seats and over. Moreover, the new entity would become the only commuter manufacturer covering the entire range of commuter aircrafts. Finally, the merged entity would have about 80 airline customers, compared to only 27 for Saab and 20 for Fokker.

The Commission then turned to an assessment of the strength of the remaining competitors. All six competitors of the new entity were carefully examined. The Commission focused on their market share as well as on their present and expected future performance in the commuter market. In this way, it tried to predict the influence of the proposed concentration on each of the remaining competitors. It concluded its inquiry by stating that “ ‘effective competition for the combined entity would only be maintained in the market for 20 to 39-seat commuters although even here the ability of the competitors to compete with the combined entity would lessen to a certain extent given the overall advantages to ATR / de Havilland arising from a broad sales base and coverage of all the markets.’ ”<sup>253</sup>

The next step in the Commission's assessment of the impact of the proposed concentration consisted in analyzing the position of customers in the commuter markets. With regard to the established airlines, which already had purchased ATR or de Havilland commuters, the Commission argued that they lacked substantial bargaining power due to a so-called ‘lock-in effect.’<sup>254</sup> As to new airlines, they have equally weak bargaining power since they will mostly acquire only a limited number of aircraft. Often these new airlines won't buy any aircraft, but will rather try to enter the market through leasing. Such leasing companies cannot be said to have much bargaining power either, because they are almost compelled to buy only “the products which are best established on the market to avoid the risk of being left with stocks.”<sup>255</sup> Therefore, these companies should be seen as “market followers rather than market makers,” which significantly restrains them from exercising “bargaining power where there is insufficient competition on the markets.”<sup>256</sup>

Considering all these factors — the very strong position of ATR / de Havilland in the overall world and Community commuter market, the relative weakness of its competitors and the limited bargaining ability of the costumers — the Commission came to the evident conclusion that

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<sup>253</sup> Aérospatiale-Alenia / de Havilland, *supra* note 20, at 54 (para. 42).

<sup>254</sup> Once an airline has made a commitment to a particular commuter manufacturer, there are significant economic and technical constraints which prevent the airline, whatever its size, from switching to the aircraft of another manufacturer. This is what is called the ‘lock-in effect.’ *Cf.* Aérospatiale-Alenia / de Havilland, *supra* note 20, at 52 (para. 33).

<sup>255</sup> Aérospatiale-Alenia / de Havilland, *supra* note 20, at 55 (para. 47).

<sup>256</sup> *Id.*

“the new entity could act to a significant extent independently of its competitors and customers, and would thus have a dominant position on the commuter market as defined.”<sup>257</sup>

After this conclusion, only one more question had to be answered, namely whether this dominant position would significantly impede effective competition in the Common Market or in a substantial part of it.<sup>258</sup> The utility of this extra requirement, and how it influences the Commission’s analysis, will be explained in the third and final chapter of this paper. But first, a comparison of the European “dominant position test” with the “incipiency test” of Section 7 of the Clayton Act.

## Section 2: Comparison With U.S. Law

Section 7 of the Clayton Act prohibits in very general terms, mergers if their effect “may be substantially to lessen competition or tend to create a monopoly.”<sup>259</sup> The meaning of this substantive test has developed through both case law and guidelines of the Department of Justice and the Federal Trade Commission. It is obvious that the test significantly differs from the one prescribed in Article 2 (2) and (3) of the Merger Regulation. As we have indicated above, the latter requires the effective creation or strengthening of a position of *actual* dominance, before the concentration can be found to violate the Merger Regulation. The U.S. enforcement ‘trigger,’ on the other hand, will go off at a much earlier stage, namely whenever the merger’s effect “*may be* substantially to lessen competition.” (emphasis added)<sup>260</sup>

In this respect, the 1984 Merger Guidelines indicate how the Department of Justice interprets this so-called “incipiency test” of Section 7

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<sup>257</sup> *Id.* at 56 (para. 51).

<sup>258</sup> *Cf.* Article 2 (3) of the Merger Regulation.

<sup>259</sup> *Cf.* Section 7 of the Clayton Act.

<sup>260</sup> This is the so-called “incipiency test” of Section 7 of the Clayton Act. The Senate Report on the original Clayton Act explicitly provided that Section 7 was intended to reach incipient monopolies and trade restraints outside the scope of the Sherman Act. *See* S. Rep. No. 698, 63d Cong., 2d Sess. 1. The theme was taken into consideration again in 1950, when Section 7 was substantially revised. The final Senate Report provided:

The use of these words [“may be”] means that the bill . . . would not apply to the mere possibility but only to the reasonable probability of the prescribed effect . . . The words “may be” have been in Section 7 of the Clayton Act since 1914. The concept of reasonable probability conveyed by these words is a necessary element in any statute which seeks to arrest restraints of trade in their incipency and before they develop into full-fledged restraints violative of the Sherman Act. A requirement of certainty and actuality of injury to competition is incompatible with any effort to supplement the Sherman Act by reaching incipient restraints.

S. Rep. No. 1775, 81st Cong., 2d Sess. 6.

Although the legislative history thus makes clear that Section 7 was intended to control mergers before they have the actual effect of reducing competition, the 1984 and 1992 Guidelines do not refer, at least not explicitly, to this incipency idea anymore.



of the Clayton Act and, thus, what conditions have to be fulfilled before it will challenge a merger or acquisition. Although the Merger Guidelines might not be representative of the current state of the law in every respect, they nevertheless offer a useful reference point for comparing current U.S. merger analysis with the approach taken by the Commission under the Merger Regulation.<sup>261</sup> We will therefore first highlight the general approach of the Guidelines, before pointing out the main differences between the U.S. and the E.C. merger policies.

Both the post-merger concentration of the market and the amount of increase in concentration caused by the merger take a central place in the Guidelines' analysis of horizontal mergers.<sup>262</sup> In order to express the level of concentration, the Guidelines refer to the Herfindahl-Hirschman Index (HHI),<sup>263</sup> which is calculated "by summing the square of the individual market shares of all the firms included in the market."<sup>264</sup> On the basis of the post-merger HHI, a distinction is made among three categories of markets. Where the post-merger HHI is below 1000, the market is considered unconcentrated and the Department of Justice "will not challenge mergers . . . except in extraordinary circumstances."<sup>265</sup> Markets are held to be moderately concentrated where the post-merger HHI ranges from 1000 to 1800. In this category, "the Department is *likely* to challenge mergers . . . that produce an increase in HHI of more than 100 points,"<sup>266</sup> although it is still possible that the Department will conclude in the light of other factors, discussed later, that the merger is not likely to substantially lessen competition. Finally, where the post-merger HHI exceeds 1800, the market is considered to be highly concentrated and challenge is likely, unless the HHI is increased by less than 50 points.<sup>267</sup>

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<sup>261</sup> Cf. Hawk, *supra* note 32, at 922-23.

<sup>262</sup> Since virtually all significant concentrations, that have been examined so far by the Commission, were predominantly horizontal mergers, we will limit the comparison to this category of mergers. It is, however, clear that the Merger Regulation also applies to non-horizontal concentrations. See, e.g., Tetra Pak / Alfa-Laval, *supra* note 78. This case concerned a proposed concentration involving horizontal, vertical as well as conglomerate aspects.

<sup>263</sup> 1984 Merger Guidelines, *supra* note 12, at 26,830.

<sup>264</sup> For example, a market consisting of four firms with market shares of 10%, 20%, 30% and 40% will have an HHI of 3000 ( $100 + 400 + 900 + 1600 = 3000$ ). The HHI can, thus, range from 10,000 (in case of a pure monopoly) to a number approaching zero (in case of a pure atomistic market). Cf. 1984 Merger Guidelines, *supra* note 12, at 26,831 n.14.

<sup>265</sup> 1984 Merger Guidelines, *supra* note 12, at 26,831.

<sup>266</sup> *Id.*

<sup>267</sup> In addition, the 1984 Guidelines indicated that the Department was likely "to challenge the merger of any firm with a market share of at least one percent with the leading firm in the market, provided the leading firm has a market share that is at least 35 percent." 1984 Merger Guidelines, *supra* note 12, at 26,831.

The new 1992 Merger Guidelines seem to have preserved or even extended this so-called "leading firm proviso." They state:

The level of market concentration is thus a first yardstick in the Department of Justice's merger analysis. When high post-merger HHI's are reached and the increase in HHI is not insignificant, then the Department will still examine a number of other criteria, before deciding to challenge the merger. These criteria are important since they may indicate situations in which market data might understate or overstate a firm's competitive significance. Possible changing market conditions, the financial strength of firms in the market<sup>268</sup> and special factors affecting foreign firms<sup>269</sup> are some of the factors the Department will consider here. Furthermore, the Department of Justice will also examine the ease of entry as well as the likelihood of oligopolistic collaboration.<sup>270</sup> Fi-

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where products are relatively undifferentiated and capacity primarily distinguishes firms and shapes the nature of their competition, the merged firm may find it profitable unilaterally to raise price and suppress output. . . . Where the merging firms have a combined market share of at least thirty-five percent, merged firms may find it profitable to raise price and reduce joint output below the sum of their premerger output . . . . This unilateral effect is unlikely unless a sufficiently large number of the merged firm's customers would not be able to find economical alternative sources of supply, i.e., competitors of the merged firm likely would not respond to the price increase and output reduction by the merged firm with increases in their own outputs sufficient in the aggregate to make the unilateral action of the merged firm unprofitable.

1992 Merger Guidelines, *supra* note 13, at 20,573-9.

<sup>268</sup> This criterion is not explicitly mentioned anymore in the new 1992 Guidelines. It is, however, arguable that the financial strength of the firms in the market will still be taken into account when assessing the likelihood of coordinated interaction. Indeed, the 1992 Guidelines refer in very general terms to "the characteristics of buyers and sellers" as one of the factors that might influence successful coordination between firms. *Cf.* 1992 Merger Guidelines, *supra* note 13, at 20,573-7.

<sup>269</sup> Present market shares, for example, will overstate the competitive significance of foreign firms that cannot increase their shipments to the U.S. in response to a significant price increase here, because of quotas, other trade restraints, or exchange rates. *Cf.* 1984 Merger Guidelines, *supra* note 12, at 26,832.

The 1992 Merger Guidelines take into account these 'special factors affecting foreign firms' at an earlier phase in the merger analysis, namely when calculating the market shares of the firms in the market. In this context, the 1992 Guidelines state: "If shipments from a particular country to the United States are subject to a quota, the market shares assigned to firms in that country will not exceed the amount of shipments by such firms allowed under the quota." 1992 Merger Guidelines, *supra* note 13, at 20,573-5. Footnote 16 of the new Merger Guidelines adds, however, that the constraining effect of quotas on the ability of importers to expand their sales, will be taken into account when evaluating the potential adverse competitive effect of mergers. This proves that, at least to a certain extent, foreign imports will still receive special attention in the evaluation of the market data.

<sup>270</sup> Both factors have received very broad attention in the new 1992 Guidelines.

With regard to the ease of entry, they use a three step methodology in order to predict whether committed entry by an outside firm can deter or counteract a competitive effect of concern:

The first step assesses whether entry can achieve significant market impact within a timely period. If significant market impact would require a longer period, entry will not deter or counteract the competitive effect of concern.

The second step assesses whether committed entry would be a profitable and, hence, a likely response to a merger having competitive effects of concern. . . . the profitability of such committed entry must be determined on the basis of premerger market prices over the long term.

The third step assesses whether timely and likely entry would be sufficient to return market prices to their premerger levels. This end may be accomplished either through multiple entry or individual entry at sufficient scale. Entry may not be sufficient, even though timely and likely,

nally, parties to the merger are allowed to establish "by clear and convincing evidence"<sup>271</sup> that a merger will achieve significant net efficiencies.<sup>272</sup> If they are able to convince the Department that such efficiencies exist, then the Department will consider them in deciding to challenge the merger. However, where "equivalent or comparable savings can reasonably be achieved . . . through other means,"<sup>273</sup> the Department will reject the claims of efficiencies.

There are, it is clear, a number of similarities between the E.C. Commission's approach and the approach taken under the 1984 Merger Guidelines. Thus, both market shares and their increase through merger have a significant place in the Commission's merger analyses. The financial strength of the firms on the market and possible changes in market conditions,<sup>274</sup> are two more factors that are taken into account by the Commission. Nevertheless, it is our opinion that there are far more differences than similarities between the U.S. "incipiency test" of Section 7 of the Clayton Act (and the way in which this test is applied by the Merger Guidelines) and the "dominant position test" of Article 2 (2) and (3) of the Merger Regulation.

The first significant difference concerns the role of oligopolistic structure. As indicated above, this issue has for the first time received major attention in Nestlé / Perrier, where the Commission stated that the Regulation does cover situations of oligopolistic dominance. Nevertheless, in the U.S., oligopolistic structure and its dangers for supra-competitive pricing still have a more central place in merger enforcement. The reference, in the Merger Guidelines, to the HHI makes this clear. Suppose, for example, a market consisting of five firms with market

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where the constraints on availability of essential assets, due to incumbent control, make it impossible for entry profitably to achieve the necessary level of sales. . . . the Agency will rely on all available evidence bearing on whether entry will satisfy the conditions of timeliness, likelihood, and sufficiency.

1992 Merger Guidelines, *supra* note 13, at 20,573-9 to 20,573-11.

As to the likelihood of coordinated interaction, the 1992 Guidelines examine in detail a whole set of factors that might influence the success or the probability of coordinated interaction. Among others, the following market factors are considered to be relevant:

the availability of key information concerning market conditions, transactions and individual competitors; the extent of firm and product heterogeneity; pricing or marketing practices typically employed by firms in the market; the characteristics of buyers and sellers; and the characteristics of typical transactions.

1992 Merger Guidelines, *supra* note 13, at 20,573-7.

<sup>271</sup> 1984 Merger Guidelines, *supra* note 12, at 26,834.

<sup>272</sup> Examples of efficiencies that will be taken into consideration by the Department of Justice, are "achieving economies of scale, better integration of production facilities, plant specialization, lower transportation costs, and similar efficiencies relating to specific manufacturing, servicing or distribution operations of the merging firms." 1984 Merger Guidelines, *supra* note 12, at 26,834.

<sup>273</sup> 1984 Merger Guidelines, *supra* note 12, at 26,834.

<sup>274</sup> This factor will be examined in Chapter 3 of this paper.

shares of 35%, 25%, 20% and twice 10%. A merger of one of the firms with a 10% market share with the firm having 20% of the market arguably would not raise any difficulties in the European Community. The Commission would probably emphasize that the new entity would not become a market leader in the relevant market, and that there were still significant competitors left. Consequently, the merger would be cleared. In the U.S., on the contrary, it is very likely that the same merger would be challenged by the Department of Justice or the Federal Trade Commission. Indeed, the post-merger HHI would be as high as 2850<sup>275</sup> with an increase of 400 points.<sup>276</sup> The market would thus be considered to be highly concentrated and a challenge of the merger by the Department of Justice would most likely occur.

A second important distinction, that directly results from the previous one, concerns the tolerated height of the market share of the new entity. In the E.C., a proposed concentration is presumed to be compatible with the common market, when the combined market share of the merging companies does not exceed 25%.<sup>277</sup> In the U.S., on the other hand, a 25% or even a 20% post-merger market share in a highly concentrated market can suffice for the merger to be challenged by the Department of Justice.<sup>278</sup>

A third and final difference relates to the role of efficiencies in the assessment of a merger. As we have pointed out above, the Merger Regulation prescribes that the development of technical and economic progress can only be taken into account insofar as "it is to consumers' advantage and does not form an obstacle to competition."<sup>279</sup> Subsequent declarations of former Commissioner Sir Leon Brittan have removed the last doubts as to the meaning of this provision by underlining that no

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<sup>275</sup> The post-merger HHI will indeed be equal to:  $[(35)^2 + (30)^2 + (25)^2 + (10)^2] = [1225 + 900 + 625 + 100] = 2850$ .

<sup>276</sup> It is possible to calculate the increase in concentration, as measured by the HHI, independently of the overall market concentration, by simply doubling the product of the market shares of the merging firms. In our example, the merger of the firms with market shares of 10% and 20% increases the HHI by 400 ( $10 \times 20 \times 2 = 400$ ).

The explanation for this technique is as follows: In calculating the HHI before the merger, the market shares of the merging firms are squared individually:  $(a)^2 + (b)^2$ . After the merger, the sum of those shares would be squared:  $(a + b)^2$ , which equals  $a^2 + 2ab + b^2$ . The increase in the HHI is therefore represented by  $2ab$ .

1984 Merger Guidelines, *supra* note 12, at 26,831 n.15.

<sup>277</sup> Cf. Recital 15 of the Merger Regulation.

<sup>278</sup> Suppose, for example, a market consisting of six firms, four firms having a 20% market share and the remaining two firms a 10% market share. If the latter two would merge, the post-merger HHI would be as high as 2000 ( $400 + 400 + 400 + 400 + 400 + 400 = 2000$ ), with an increase through merger of 200 points ( $10 \times 10 \times 2 = 200$ ). This brings the merger in the zone where challenge by the Department of Justice is highly likely.

<sup>279</sup> Cf. Article 2(1)(b) of the Merger Regulation.

efficiency defence would be possible whenever the merger creates or strengthens a dominant position. In the U.S., on the other hand, an efficiency defence is allowed at all times, even when the post-merger HHI is impressive and a challenge by the Department of Justice highly likely. It may sound paradoxical, but this last difference might bring the European and American approaches somewhat closer to one another. Indeed, the more the Department of Justice takes into account efficiencies, the greater the chance that mergers producing high post-merger HHI's and significant increases in HHI, will nevertheless not be challenged.

### CHAPTER 3: SIGNIFICANT IMPEDIMENT OF EFFECTIVE COMPETITION

As we have indicated above, the decision that a dominant position is created or strengthened, is not itself sufficient to declare a concentration incompatible with the Common Market. In the third and last step of its analysis, the Commission must examine whether this creation or strengthening of a dominant position would also significantly impede effective competition in the Common Market or in a substantial part of it.<sup>280</sup>

The goal of this additional requirement was indicated in the *Aérospatiale-Alenia / de Havilland* case,<sup>281</sup> in which the Commission dealt for the first time with the issue. After concluding that the proposed concentration would create a dominant position, the Commission stated, "In general terms, a concentration which leads to the creation of a dominant position may however be compatible with the Common Market within the meaning of Article 2 (2) of the Merger Regulation if there exists strong evidence that this position is only temporary and would be quickly eroded because of a high probability of strong market entry. With such market entry the dominant position is not likely to impede effective competition within the meaning of Article 2 (3) of the Merger Regulation."<sup>282</sup>

This statement makes clear that the Commission will take a future-oriented look at the created or reinforced dominant position. Where "strong evidence"<sup>283</sup> indicates that there are no, or very low barriers to market entry, no real danger to competition can be expected and the merger will be cleared.<sup>284</sup> If, on the other hand, it is more likely that the dominant position will persist in the near future, then a real threat for the

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<sup>280</sup> Cf. Article 2(3) of the Merger Regulation.

<sup>281</sup> *Aérospatiale-Alenia / de Havilland*, *supra* note 20.

<sup>282</sup> *Id.* at 56 (para. 53).

<sup>283</sup> *Id.*

<sup>284</sup> See also BRITTAN, *supra* note 185, at 36-37.

competitive structure of the market exists and the concentration will be declared incompatible with the Common Market.

In *Aérospatiale-Alenia / de Havilland*, the Commission concluded that there was “no realistic significant potential competition in the commuter markets for the foreseeable future.”<sup>285</sup> In particular, the Commission pointed to three economic factors that made entrance on the market by a newcomer highly unlikely. First, it indicated that the commuter markets were almost mature, and would probably decline and stabilize beginning in the mid-1990’s. Moreover, it would take at least six to seven years to develop a commuter aircraft from scratch. Finally, high sunk costs of development and marketing, combined with the likely evolution of the market, made it doubtful whether a new entrant could ever achieve a “break-even level of sales.”<sup>286</sup> The Commission further examined the parties’ claim of potential entry from Eastern or developing countries.<sup>287</sup> It held, however, that this entry was too speculative to be regarded as significant potential competition under the Merger Regulation.

Two remarks can be made with regard to this requirement of significant impediment of effective competition. First, it is clear that the requirement confers additional flexibility to the Commission in its assessment of mergers. It allows the Commission to examine the consequences of the proposed concentration in a somewhat broader time-perspective. The advantage is obvious. Without the requirement, the Commission would have to prohibit even the smallest reinforcement of a dominant position, regardless of whether it would have any measurable impact on the affected market.<sup>288</sup> However, additional flexibility may also open the door for industrial or social policy considerations. It is therefore important that the Commission continue to require “strong evidence”<sup>289</sup> of near-future potential entry, rather than accepting vague speculations about new market entry. In this sense, the Commission’s first application of the requirement is certainly a step in the right direction.

Second, as we have already indicated above,<sup>290</sup> both the 1984 and 1992 Merger Guidelines likewise take into account the influence of

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<sup>285</sup> *Aérospatiale-Alenia / de Havilland*, *supra* note 20, at 58 (para 63).

<sup>286</sup> *Id.* at 57 (para. 56).

<sup>287</sup> The parties especially referred to ACAW (Aero Czechoslovak Aeronautical Works), IPTN (Industri Pesawat Terbang Nusantara, an Indonesian Company) and the Ilyshin 114 (an aircraft developed for the former Soviet Union and the former Comecon countries) as potential entrants on the relevant commuter markets.

<sup>288</sup> *Langeheine*, *supra* note 179, at 485-86.

<sup>289</sup> *Aérospatiale-Alenia / de Havilland*, *supra* note 20, at 58 (para 63).

<sup>290</sup> *See, supra* notes 260 and 264.

changing market conditions as well as the ease of entry when interpreting the significance of market shares and concentration. On this point, no major differences exist between the EC Commissions approach and the approach taken under the 1984 and 1992 Guidelines.

### CONCLUSION

The adoption of the EC Merger Control Regulation on December 21, 1989, has been a major step toward European unification. For the first time in the European Community's history, all Member States agreed to transfer the power to review large mergers to the Commission. Although barely nine months separated the Regulation's adoption and its effective date, Sir Leon Brittan, the former EC Competition Commissioner, has still managed to set up a well-functioning organ, the Merger Task Force, that assists in the assessment of the mergers falling within the scope of the Regulation. This task force, which operates within the Directorate-General for Competition Policy, is staffed by lawyers, economists and accountants. Many of its members have been active in national competition authorities. Up to now, the cooperation between the Competition Commissioner and the Merger Task Force has proven to function very well. In all cases, the strict time limits prescribed in the Regulation have been respected. Undeniably, this is a significant achievement, both from a lawyer's and a businessman's perspective. Quick decisions within predictable time limits are very much needed in merger cases, where huge amounts of money are often at stake.

Nevertheless, it is our opinion that the Merger Regulation, both as it is written and applied today, can be no more than the first step toward a full-scale control of all larger mergers on the European level.

First, it is clear that, as the Regulation is written today, only the largest cross-border mergers fall within its scope. Even though this aspect of the Regulation was not a focus of this paper,<sup>291</sup> it is clear that a full-grown merger control on the EC level will only be possible when the turnover thresholds are significantly lowered. Article 1 (3) of the Regulation provides, however, that the thresholds, laid down in Article 1 (2), must be reviewed by the Council of Ministers, acting by a qualified majority, before the end of 1993. If the thresholds are significantly lowered,<sup>292</sup> then a first major barrier to full-scale European merger control will be removed.

Removing what we see as the second barrier to a mature merger

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<sup>291</sup> See, *supra* note 5.

<sup>292</sup> *Id.*

control system will be more difficult and might take much longer. In this context, we have amply demonstrated two major weaknesses in the Commission's approach by inquiring into almost half of the Commission's decisions.

On the one hand, a clear and structured approach toward the problem of product and geographic market definition is still lacking. Although it was possible to divide the Commission's decisions into three groups, with similar criteria applied to each, it continues to be difficult to predict how the Commission will define the relevant market in a particular case. The American usage of issuing merger guidelines offers a good example of a way for the Commission to clarify its approach to market definition.

On the other hand, the requirement of dominance, as it is applied today, is a very restrictive one that will be realized in only a limited number of cases. Experience in the U.S. has proven that a lessening of competition flows only rarely from a position of independent dominance, "but much more frequently form a situation where a small number — three, four, five, six — firms are strongly interdependent, and very consciously interdependent, among themselves."<sup>293</sup> Although the Commission has introduced the concept of oligopolistic dominance in its assessment of mergers, the concept still has a limited impact. As a consequence, the Regulation only governs situations where the largest company in terms of market shares takes over a direct competitor or where the concentration creates a new market leader.

Business people and their lawyers are thus clearly well served by the Commission. They get both timely and favorable decisions. Whether this approach also serves consumers is questionable.

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<sup>293</sup> Symposium, *Substantive Review under the Merger Regulation*, 1990 FORDHAM CORP. L. INST. 564 (Barry Hawk ed., 1991).