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The leveraging theory as a tool in EC merger control

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Summary

In the early years of EC merger control, the Commission generally concluded that conglomerate mergers would not cause competitive harm. In recent years, however, the Commission has increasingly developed theories of competitive harm which are applicable to mergers which lack appreciable horizontal and vertical effects. The leveraging theory is typically applied in conglomerate mergers, where the markets concerned are neighbouring ones. The prediction is that the merger would provide a dominant or leading company with the tools to leverage its market power into its merging party’s product market, by bundling or tying the products together. This would reduce the number of customers of the competitors in the tied market and ultimately force competitors out.

This thesis establishes the conditions under which a merger may be prohibited on grounds of leveraging and examines the applicability of the theory. Moreover, the thesis reflects on the adequacy of pursuing arguments based on leveraging in the merger procedure, considering the post-merger availability of Article 82 EC.

The Community Courts have not yet accepted the Commission’s appraisal of leveraging. However, the Merger Regulation does not preclude basing a prohibition decision on grounds of leveraging. According to the jurisprudence of the Tetra/Sidel and GE/Honeywell cases, it must be shown that the parties possess both the ability and the incentive to engage in the alleged behaviour. Moreover, it must be established that the activities would lead to the emergence of a SIEC in the relatively near future. In the fulfilment of this test lie a number of problematic issues. For example, predictions on future behaviour involve evidentiary difficulties. As regards the capability of leveraging of causing competitive harm, the legalistic and economic-based approaches differ substantially. Whilst economists underline the efficiencies and short-term consumer benefit normally deriving from conglomerate mergers, the SIEC test requires an examination of the overall effects on competition. The crucial factor is whether the merger would lead to a sufficient competitor foreclosure in the relatively near future.

The advantages of the ex post examination of leveraging have been emphasised in the doctrine. For instance, a wait-and-see approach would allow the competition authority to see whether the practices will actually occur and whether they are exclusionary or efficiency enhancing. However, some of the conduct capable of creating a SIEC under the Merger Regulation would not be abusive under Article 82 EC. This would be the case where, e.g., the leveraging strategy would lead to high entry barriers but not to increased prices. Hence, the sole application of Article 82 EC would not suffice in order to deal with the conduct predicted in merger cases.
### Abbreviations

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<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ABA</td>
<td>American Bar Association</td>
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<td>AG</td>
<td>Advocate General</td>
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<td>CFI</td>
<td>Court of First Instance</td>
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<td>CMLRev</td>
<td>Common Market Law Review</td>
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<td>DG</td>
<td>Directorate General</td>
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<td>EAGCP</td>
<td>Economic Advisory Group for Competition Policy</td>
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<td>EC</td>
<td>European Community alt. Treaty establishing the European Community</td>
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<td>ECJ</td>
<td>European Court of Justice</td>
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<td>ECLR</td>
<td>European Competition Law Review</td>
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<td>ECR</td>
<td>European Court Reports</td>
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<td>EEC</td>
<td>European Economic Community</td>
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<td>EU</td>
<td>European Union</td>
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<td>GE</td>
<td>General Electric Company</td>
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<td>nyr</td>
<td>not yet reported</td>
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<tr>
<td>OJ</td>
<td>Official Journal of the European Union</td>
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<tr>
<td>PET</td>
<td>Polyethylene terephthalate</td>
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<tr>
<td>SIEC</td>
<td>Significant Impediment to Effective Competition</td>
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<td>SLC</td>
<td>Substantial Lessening of Competition</td>
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<td>US</td>
<td>United States</td>
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1 Introduction

1.1 Background

On the 3rd of July in 2001, the Commission rejected the $43 billion merger between GE and Honeywell. The decision was controversial, since the merger had earlier been approved by the US Department of Justice. According to the Commission, the concerns of the merger consisted in the presumed ‘leveraging activities’, e.g. the plausible activities by means of which the dominant company GE would be able to turn Honeywell’s leading positions in other markets into dominant ones. Later on the same year, the Commission prohibited the proposed merger between Tetra Laval and Sidel on similar grounds.

In the early years of EC merger control, the Commission mainly focused on vertical and horizontal mergers. It generally concluded without detailed analysis that conglomerate mergers would not give rise to anti-competitive effects. In recent years, however, the Commission has developed theories focusing on anti-competitive effects which do not derive from horizontal or vertical relations. One of these theories is the theory applied in the GE/Honeywell and Tetra/Sidel decisions – the leveraging theory.

Thus far, the Commission’s application of the theory has not been upheld by the Community Courts. However, it is established that conglomerate mergers are not legal per se and that concerns based on leveraging may, in some cases, result in a prohibition decision. The questions arising after the Tetra/Sidel and GE/Honeywell rulings are many: Under which conditions may the application of the leveraging theory be a successful means of prohibiting a merger? In assessing the effects on competition, what is the scope for considering the consumer benefits to which conglomerate mergers may give rise? Considering the Courts’ dismissal of the Commission’s findings, what is the status of the leveraging theory as a tool in fighting potentially harmful mergers?

Additional questions regarding leveraging relate to the post-merger control available under Article 82 EC. Article 82 EC explicitly addresses the tying practices which the Commission may define as leveraging practices in merger procedures. Considering the existence of Article 82 EC, should tying and bundling be examined within the system of ex ante control laid down in the Merger Regulation? There is no clear answer to these questions.

3 Case COMP/M.2416 Tetra Laval/Sidel, Commission decision of 30 October 2001.
However, they have been extensively discussed after the Tetra/Sidel and GE/Honeywell cases.

1.2 Purpose

The purpose of this thesis is to establish the conditions under which a merger may be prohibited on grounds of leveraging, to examine the applicability of the theory and to reflect on the adequacy of applying the leveraging theory when making assessments under the Merger Regulation.

1.3 Method

When seeking satisfying answers to the questions raised above, those questions must be placed in a proper methodological framework. Considering the growing importance of economics in EC merger control, I find it appropriate to place the leveraging theory in a wider context than the strictly legal one. Accordingly, I will firstly utilise a traditional legal method in order to establish the law and secondly integrate an economic perspective when examining the effects of the law.

As regards the legal status of the leveraging theory, a thorough examination of the relevant judgments is required. Whilst the Courts have recognised in principle the validity of leveraging arguments, a leveraging case must fulfil a number of requirements. By means of case law analysis, the conditions under which a leveraging case is successful will be established. This will include a discussion on issues which are related to the requirements laid down, reflecting on the legal as well as economic aspects of leveraging.

Concerning the adequacy of pursuing leveraging concerns in the merger procedure, the examination will more specifically be carried out in comparison with the ex post application of Article 82.

The analysis will be woven into the text, rather than being gathered under one single heading. The requirements of leveraging touch upon a number of related issues. I find it appropriate to allow for reflections in direct connection to these issues. The main findings of the thesis will then be summarised in the last chapter.

The words ‘merger’ and ‘concentration’ will be used interchangeably in this thesis. Thus, no difference in the significance of the two is intended.
1.4 Material

The 2004 Merger Regulation is of central importance for the purposes of this thesis. Further, Article 82 EC is relevant to the examination. The Merger Regulation contains no specific provisions regarding leveraging or conglomerate mergers. However, the position of the Community Courts has been disclosed in the two lengthy cases mentioned above: Tetra/Sidel and GE/Honeywell. The judgments constitute the key material when establishing the requirements of leveraging.

In February 2007, the Commission published Draft Guidelines on the assessment on non-horizontal mergers. Although the Notice is not final, it sets out the Commission’s approach to conglomerate mergers and to leveraging. The relevant parts of the Draft Guidelines will therefore be used in the analysis.

The literature dealing with the appraisal of leveraging cases is fairly limited. Nevertheless, some books provide valuable information on leveraging and related issues. EC Merger Control by Cook and Kerse (2005) should be mentioned, as well as Competition Classics by Lidgard (2006). As to the economic dimension of competition law, The Economics of EC Competition Law by Bishop and Walker (2002) is of importance.

The concept and utilisation of leveraging in merger control have been extensively discussed in doctrinal articles. The articles chosen for the purposes of this thesis will hopefully add interesting features. The intention is to present a balanced discussion, involving contrasting arguments of different authors.

1.5 Delimitations

This thesis will examine the utilisation of leveraging as a distinct theory in European merger control. As a result, traditional theories of competitive harm, identified in horizontal and vertical mergers, will be excluded from examination. However, as arguments based on leveraging generally constitute one of several lines of reasoning raised in conglomerate mergers, the thesis will inevitably touch upon conglomerate mergers in general.


8 Other arguments in conglomerate mergers may be based on spill-over effects from neighbouring markets and the overall position of the merged entity, see Case T-5/02 Tetra Laval BV v Commission [2002] ECR II-04381, paras. 324-335.
The field of examination is limited to the European Union. Nevertheless, contrasts will sometimes be drawn to the US approach in order to present a different point of view.

It is the intention of this thesis not to plunge too deeply into merger control as such. Therefore, the presentation of the legal framework will focus on aspects specifically relevant to the purposes of this thesis. Due to the narrow objective, the reader should be familiar with EC competition law and the basic concepts of EC merger control.

1.6 Outline

The thesis will start with providing the essential definition of leveraging and the legal context in which leveraging appear. The focus will then shift to the Tetra/Sidel and GE/Honeywell cases. Chapter 3 will provide a comprehensive presentation of the facts and the outcomes of the cases. The following two chapters will discuss the requirements under which the leveraging theory may be successful. Chapter 6 will reflect on the post-merger application of Article 82 EC as a remedy for leveraging. The last chapter will briefly summarise the applicability of the leveraging theory in the light of the requirements set out by the Courts. It will also conclude on the adequacy of pursuing leveraging concerns under the Merger Regulation.
2 Legal context and definitions

Before presenting the legal framework in which leveraging may arise, a proper definition of leveraging should be provided. The intention is to provide a first, comprehensible definition of the concept as utilised in Community competition law.

2.1 Definition of leveraging

There is no received definition of leveraging. However, in a neutral sense, it is being able to increase sales of a product in one market (the “tied market” or “bundled market”), by virtue of the strong market position of the product to which it is tied or bundled (the “tying market” or “leveraging market”). Through the utilisation of leveraging practices, a dominant or leading firm can extend its market power in one market to another market, where it did not have this power previously.

Typically, concerns relating to leveraging arise where the markets concerned are neighbouring ones. Where two markets are closely linked to each other, or even offering complementary products, a firm active in both of those markets may be tempted to tie or bundle the products together. Ultimately, this could reduce the number of customers of its competitors in the tied or secondary market and force rivals out of this market. Thus, the main concern of leveraging is the competitor foreclosure to which is may give rise.

2.1.1 Leveraging practices

The kinds of leveraging practices investigated by the Commission and the Community Courts thus far can be divided into:

i) tying (or “pure bundling”),
ii) mixed bundling, and
iii) technical bundling.

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9 The Draft Guidelines, fn. 76.
10 It is not required that the company be dominant, but it must possess “market power”, see the Draft Guidelines, para. 98.
13 Tying and bundling may also lead to price discrimination and higher prices, see the 2005 Discussion Paper, para. 179.
To engage in tying or pure bundling is to make the sale of product A conditional upon the customer also purchasing product B. By means of such practices, a company active in the market of product A can extend its market power to the market of product B. In the *Tetra/Sidel* decision\(^\text{15}\), the Commission feared that Tetra would engage in such activities post-merger.

In a case of mixed bundling, products A and B will continue to be sold separately, but customers buying both products together will receive a lower price. This type of bundling may be particularly attractive where the products are complementary, *i.e.* where a price decrease in product A increases demand not only for product A but also for product B. In terms of economics, this enables a company with an expanded product portfolio to internalise price externalities, *i.e.* to capture some of the additional demand for complementary product B resulting from the price decrease for product A (rather than benefiting all other suppliers of product B).\(^\text{16}\) This type of bundling was alleged in the *GE/Honeywell* decision.\(^\text{17}\)

Technical bundling, lastly, is achieved where the merged entity produces a single product incorporating both products A and B, thus integrating products from two different markets into a single product. This type of bundling has been extensively discussed in the US and EU investigations of various commercial practices by Microsoft.\(^\text{18}\) Technical bundling may also be achieved where the entity makes product A technically incompatible with any product B manufactured by a competitor.\(^\text{19}\)

### 2.2 Leveraging and Article 82 EC

Tying is prohibited under Article 82(d) EC, exemplifying as an abuse of a dominant position “…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 contracts...”.

In the *Tetra Pak II* case, the ECJ investigated whether a company dominant in one market had committed an abuse in a market where it was not dominant. The Court established that Tetra Pak’s dominance in the aseptic market could affect the neighbouring non-aseptic market, due to the close “associative links” between the two markets. For instance, Tetra Pak’s existing customers in one sector were potential customers also in the other. Due to its quasi-monopoly in the aseptic market, Tetra Pak could focus on the non-aseptic market and act independently of its competitors.\(^\text{20}\)

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\(^{15}\) Case COMP/M.2416 Tetra Laval/Sidel, Commission decision of 30 October 2001.

\(^{16}\) Völcker, 2003, p. 584.

\(^{17}\) Case COMP/M.2220 General Electric Company/Honeywell, OJ 2004 L 48.

\(^{18}\) Völcker, 2003, p. 584.

\(^{19}\) See, *e.g.*, Case COMP/M.1879 Boeing/Hughes, Commission Decision of 29 October 2000, paras. 82-83.

Court found that Article 82 EC was applicable to the situation and the tying in which Tetra engaged was deemed incompatible with the common market.21

Hence, Article 82 EC addresses behaviour which may be regarded as part of a leveraging strategy. Nevertheless, the examination of leveraging may be performed at an earlier state, namely in the *ex ante* examination of a proposed merger.

### 2.3 Pursuing leveraging concerns under the Merger Regulation

The 2004 Merger Regulation22 applies to all concentrations with a Community dimension, *i.e.* mergers which exceed the thresholds set out in Article 1. Before implementing such a merger, the parties must notify it to the Commission. The Commission initiates investigations in order to establish whether the concentration is compatible with the common market. The procedure is fast track; the review shall extend to no more than 90 days. Should the Commission fail to deliver a decision within this time, the merger is automatically deemed compatible with the common market in accordance with Article 10.

#### 2.3.1 The ‘SIEC test’

The general test for all mergers, contained in Article 2(2) and (3), is whether the concentration would *significantly impede effective competition* in the common market, in particular as a result of the creation or strengthening of a dominant position. This test, called the ‘SIEC test’, means that the assessment of a merger shall include not only the traditional dominance evaluation23, but also an examination of how the merger would affect competition in general.

#### 2.3.1.1 General effect on competition

The examination shall include the need to maintain and develop effective competition, having regard to all the relevant markets, actual or potential competition as well as the position and economic power of the merging parties. This encompasses an examination of the market features, *e.g.* the

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23 The ‘pure dominance test’ was applied before 2004, see Article 2(3) of Merger Regulation 4064/89, stating: “A concentration which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded […] shall be declared incompatible with the common market.”
possible barriers to entry the market, supply and demand trends, alternatives available to customers and technical and economic progress. The Commission enjoys a wide scope of discretion in examining these features. It is required to carry out a prospective analysis of the effects, taking into account elements such as the market position of the merging parties, the economic power of customers and the characteristics of the markets and products involved.24

2.3.1.2 Creation or strengthening of a dominant position

Although not constituting the main purpose of the SIEC test, the strengthening or creation of a dominant position is a characteristic indicator of a SIEC.25 In cases where the merging parties are both strong actors in the same market, the addition of the pre-merger market shares may directly lead to the creation or strengthening of a dominant position.26 For instance, the acquisition by an oligopolist of a competitor may make it easier for the remaining market participants to jointly limit their output, thus driving prices up. In such a case, a SIEC is the immediate effect of the merger, and there is no need to investigate the future conduct of the parties.27

As regards leveraging, however, the predicted creation or strengthening of dominance does not relate to the combination of market shares, but to the extension of market power through the transfer of market power from one market to another. This transfer is pursued by means of the tying or bundling activities described under 2.1.1. The merger may not immediately lead to a SIEC, but is rather such as to facilitate the exclusionary conduct of the parties, which may eventually lead to the emergence of a SIEC.28 Accordingly, the prediction of the future conduct of the parties is decisive.

The rationale behind the change from the pure dominance test to the SIEC test was undoubtedly to widen the test of compatibility. The model for the new test was the SLC (Substantial Lessening of Competition) test, applied in e.g., the US.29 Since the competences of the US and the EU sometimes overlap, the narrowing of the gap between the EU and US tests may be helpful in future assessments. In the past, the points of view of the US competition authority and the European institutions have not always coincided.30

24 Lidgard, 2006, p. 373.
26 Although market shares in themselves are never sufficient to prove dominance, a very large market share is a highly important factor; See Case 85/76 Hoffman-La Roche v Commission [1979] ECR 461, para. 39.
28 ‘Exclusionary conduct’ refers to behaviour by a dominant firm which is likely to have a foreclosing effect on the market, see the 2005 discussion paper, para. 1.
2.3.2 Commitments as a remedy

Should the Commission find that the predicted tying or bundling would lead to a SIEC, the parties may propose modifications to the concentration before the adoption of the final decision. As the Commission rarely prohibits a merger outright, remedies offered by the parties have received increasing importance.\(^{32}\) If they are proportionate and would entirely eliminate the competition problem, they may be attached to the decision as an obligation, rendering the concentration compatible with the common market. Should the merged entity commit a breach of an obligation attached to the decision, the Commission may revoke the merger clearance under Articles 6(3)(b) and 8(6)(b) of the Merger Regulation.

The 2001 Remedies Notice\(^{33}\) sets out the main types of remedies that the Commission has accepted under the Merger Regulation. The Commission prefers structural remedies to behavioural ones. That is, it would prefer a remedy whereby the structural problem – growth of market share, for instance – is addressed by the merged entity agreeing to divest itself of, e.g., manufacturing capacity within a fixed period of time.\(^{34}\) Structural solutions may immediately eliminate the competition problem. However, the Commission cannot as a matter of law refuse to accept a company’s commitment to abstain from certain behaviour. In Gencor, the CFI ruled that the important question is not whether the commitment is structural or behavioural, but whether it would be sufficient to ensure that the merged entity will not create or strengthen a dominant position.\(^{35}\) The Remedies Notice recognises that also behavioural commitments may be effective, and that this is determined on a case-by-case basis.\(^{36}\)

2.3.3 Conglomerate mergers

There are no provisions in the Merger Regulation specifically addressing leveraging. Nor have the Community Courts ever accepted a prohibition of a merger on grounds of leveraging. However, the Merger Regulation does not preclude basing a prohibition decision on such concerns. This applies in particular to conglomerate-type mergers, where the relevant markets are neighbouring ones, and one of the merging parties already holds a dominant position in one of those markets. In such a situation, a merger could provide the parties with both the opportunity and incentive to exploit its existing dominance in one market to create or strengthen a dominant position in another market.\(^{37}\) Save for leveraging concerns, conglomerate mergers may

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\(^{32}\) Weibrecht, 2006, p. 43.


\(^{34}\) Whish, 2005, p. 852.


\(^{36}\) The Remedies Notice, para. 9.

produce anti-competitive effects if they reinforce a dominant position by eliminating competitive constraints in neighbouring markets (i.e. they produce ‘spill-over effects’) and if they lead to a strengthening of an overall position.38

The Commission has gradually developed theories of competitive harm that focus on the translation of competitive advantages into anti-competitive effects, despite the lack of direct horizontal overlap between the merging companies.39 The SIEC test, as well as the SLC test, allow for a broad examination of merger effects. However, whilst the Commission has increasingly focused on possible anti-competitive effects of conglomerate mergers, the US position is that such mergers are legal per se. This discrepancy caused heated transatlantic debate after the CFI’s judgment of the merger between the US-based companies GE and Honeywell.40

2.3.4 Draft Guidelines on the assessment of non-horizontal mergers

In order to provide guidance specific to companies envisaging vertical and conglomerate mergers, the Commission intends to adopt Non-horizontal Guidelines. In February 2007, it published Draft Guidelines on the assessment of non-horizontal mergers.41 Similar guidance was provided regarding the assessment of horizontal mergers in 2004.42

The Draft Guidelines provide safe harbours in terms of market share and concentration levels, below which the Commission is not likely to identify anti-competitive effects.43 As regards conglomerate mergers, the Commission points out the risk of leveraging as the main concern. In order for leveraging to be at hand, three conditions must be fulfilled. The Commission examines 1) the merged entity’s ability to engage in leveraging, 2) whether it would have the economic incentive to do so and 3) whether the strategy would have a significant detrimental effect on competition, thus causing consumers harm.44

To fulfil the ‘ability’ criteria, the merged entity must have an actual possibility of linking two separate markets together through pure, mixed or

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42 Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ C 31, 05/02/2004 (hereinafter ‘the Horizontal Guidelines’).
44 Id., para. 93.
technical bundling.\textsuperscript{45} Even so, there may be effective and timely counter-strategies that the rival firms may deploy. For example, competitors may well be able to match the merged entity’s bundling strategy.\textsuperscript{46} In addition, customers may be motivated to buy the range of products from a single source (one-stop shopping) rather than from many suppliers, \textit{e.g.} because it saves on transaction costs.\textsuperscript{47}

The incentive to employ a leveraging strategy depends on the degree to which the strategy is profitable.\textsuperscript{48} The decision to bundle may increase profits by gaining market power in the tied goods’ market, or by protecting market power in the tying goods’ market.

It is only where a sufficiently large fraction of market output is affected by foreclosure resulting from the merger that the merger may lead to a SIEC. Where the new entity, prior to engaging in leveraging, has no market power in any of the markets concerned, foreclosure is unlikely to give rise to concern. The effectiveness of countervailing factors, such as competitors’ possibilities of entrance and countervailing buyer power, shall be assessed. Moreover, the effect on competition must be examined in the light of the efficiencies claimed by the parties.\textsuperscript{49}

\section*{2.4 The role of economics}

When examining the effects of leveraging on competition, regard must be had to economic theory: indeed, to a considerable extent competition law is about economics. The economic approach to competition law is that efficiency is the objective and pricing is the measuring device.\textsuperscript{50} Competition generally produces lower prices, leads to cost efficiency and improves innovation. Accordingly, competitive markets tend to lead to a higher level of consumer welfare.\textsuperscript{51}

\subsection*{2.4.1 Efficiency and consumer benefit}

Economic literature does not support the presumption that leveraging would have a negative effect on competition.\textsuperscript{52} Conversely, tying and bundling may generate substantial efficiencies. As opposed to horizontal mergers, the commercial practices predicted in leveraging cases normally do not involve

\begin{itemize}
\item \textsuperscript{45} \textit{Id.}, para. 94.
\item \textsuperscript{46} See, \textit{e.g.}, Case COMP/M.3687 Johnson&Johnson/Guidant, Commission decision of 25 August 2005, para. 339; Case COMP/M.3304 GE/Amersham, Commission decision of 21 January 2004, para. 39.
\item \textsuperscript{47} The Draft Guidelines, para. 103.
\item \textsuperscript{48} \textit{Id.}, para. 104.
\item \textsuperscript{49} \textit{Id.}, para. 109.
\item \textsuperscript{50} Lidgard, 2006, p. 11.
\item \textsuperscript{51} Bishop and Walker, 2002, p. 11.
\item \textsuperscript{52} \textit{Id.}, p. 292.
\end{itemize}
immediate price increases to consumers or, as in vertical mergers, raising rivals’ costs. In order to gain from bundling, the merged entity must persuade a sufficient number of customers to buy the bundle. This is normally achieved through lower prices. Moreover, the products manufactured in complementary relationships are by definition used together. A merger may give rise to numerous efficiency gains, such as improvement of quality, increase in variety, or increase in levels of investment. Nevertheless, economic theory recognises that ties and bundles may produce anti-competitive effects. However, this is only where the market power over the tying product is capable of foreclosing others from selling the tied product and there are not sufficient countervailing justifications.

The Commission’s main concern about leveraging is accurately that of competitor foreclosure. It recognises that the effects of a proposed merger needs to be examined “in the light of the efficiencies” identified and substantiated by the merging parties. Thus, the parties may claim that the merger would result in consumer benefit deriving from, e.g., lower prices or technical and economic progress. In order for the Commission to accept the proposed efficiencies, they must benefit consumers, be merger-specific and be verifiable. Where the Commission can conclude that the efficiencies are likely to enhance the ability and the incentive of the merged entity to act pro-competitively for the benefits of consumers, it may declare the merger compatible with the common market. In Procter&Gamble/Gillette, the Commission adopted a clearance decision, as it found that foreclosure effects from bundling would be unlikely. The Commission took into account the benefits from having only one partner to negotiate with, suppliers having stronger innovation capacities, and economies of scale and scope.

Conversely, where the Commission predicts competitor foreclosure, consumer benefits cannot outweigh the adverse effect on competition. In other words, there is no ‘efficiency defence’ in the Merger Regulation. The competitor foreclosure is a problem in itself (albeit this can be remedied by the commitments offered by the parties). The US approach to efficiencies is more straightforward: where benefits to the economy resulting from the efficiencies are deemed to outweigh the harm resulting, this allows a merger to go ahead.

34 Bishop, Lofaro and Rosati, 2006, pp. 403-404.
36 The Draft Guidelines, para. 113.
37 The Horizontal Guidelines, paras. 79-88.
38 Jd., para. 77 (referred to in the Draft Guidelines, fn. 90).
40 Cook and Kerse, 2005, p. 274. However, the defence is not available where the merger would result in a monopoly.
3 Practical assessment of leveraging

It is now appropriate to proceed to the examination of the Community Courts’ case law and, more specifically, to examine the circumstances under which leveraging arguments may be successful in merger control. As has already been emphasised, Tetra/Sidel61 and GE/Honeywell62 constitute landmark judgments. This chapter briefly presents the facts and the outcome of the two cases, whilst chapters 4, 5 and 6 constitute the argumentation part, and the nucleus, of this thesis. Some words in the Courts’ judgments are written in italics. The purpose of this is merely instructive. The key statements of the Courts will be addressed in the argumentation part.

3.1 Initial leveraging arguments

Tetra/Sidel was the first case in which the CFI examined the effects of a conglomerate merger.63 However, the Commission relied on arguments based on leveraging also before the examination of Tetra’s proposed acquisition of Sidel.

The prohibition of the Aerospatiale-Alenia/de Havilland merger in 1991 was partly based on the risk that the parties would employ leveraging activities post-merger. According to the decision, there was a risk that the merged entity would leverage its power in the market for large commuter aircraft into the market for medium-size commuter aircraft. The main problem of the merger was, however, of a horizontal nature. The combination of the pre-existing market shares of the merging parties, which were competitors, would in itself create dominance, which could eventually be converted into a monopoly.64

In Boeing/Hughes, the Commission investigated whether the merged entity would have the incentive to redesign Boeing’s launchers so as to work only with Hughes’ satellites, i.e. to pursue technical bundling. The Commission finally dismissed the argument as implausible, perceiving that such behaviour would undermine Hughes’ competitiveness in the satellite market. For instance, making Hughes satellites less compatible with other launch vehicles could be a disadvantage for Hughes, in respect of those

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63 Rivas and Branton, 2003, p. 1237.
customers requiring their satellites to be integrated with other launch vehicles.  

### 3.2 Tetra/Sidel

In October 2001, the Commission prohibited the notified merger between Tetra, a dominant company in carton packaging equipment, and Sidel, the leader in PET packaging equipment. Among other things, the Commission observed that the number of customers needing both PET and carton packaging equipment was increasing. Thus, the merger would provide Tetra with both the incentive and tools to leverage its dominant position in carton packaging into the PET packaging market.

On appeal, the CFI annulled the Commission’s decision. The Commission subsequently applied to the ECJ, which upheld the judgment of the CFI.

#### 3.2.1 Alleged leveraging practices

According to the Commission, the activities would consist of the bundling of Tetra and Sidel products and the use of predatory pricing, price wars and loyalty rebates. The adoption of such measures would ensure that Tetra’s existing carton customers would buy any PET packaging equipment they required from the merged Tetra/Sidel entity. As a result, Sidel’s competitors would become less viable and ultimately driven out of business. Tetra’s proposed commitment not to make any joint offers of Tetra Pak products and Sidel packaging equipment during a 10-year period was rejected by the Commission.

#### 3.2.2 The judgment of the CFI

The CFI ruled that the Commission had erred when relying on the consequences of leveraging by the merged entity. As opposed to the Commission’s analysis, the Court established that dominant positions on the relevant PET markets would not be created immediately post-merger. Nevertheless, it recognised that the means and capacities brought together by a conglomerate merger may create conditions allowing the entity to leverage its way so as to acquire, *in the relatively near future*, a dominant

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65 Case COMP/M.1879 Boeing/Hughes, Commission decision of 29 October 2000, paras. 82-83.
67 Case C-12/03 P Commission v Tetra Laval BV [2005] ECR I-1113.
70 Id., para. 308.
position in the other market. The Court did not clarify which time aspects could be caught by the notion of a relatively near future, but it elaborated with a period of two to three years. It then concluded that the Commission had failed to prove that Tetra/Sidel would succeed in transforming the current positions in the PET markets into dominant ones within this time. The CFI pointed out that the examination of a conglomerate mergers must be precise and supported by convincing evidence, since such mergers are generally neutral, or even beneficial.

The CFI established that the merged entity must have both the ability and the incentive to engage in the alleged activities. The Court found that the first criterion was fulfilled. Due to the close links between the two markets in question, a merged Tetra/Sidel entity would have the ability to attract successfully customers from its carton business to the PET packaging market. For example, the main suppliers in the carton markets were present also in the PET market, requiring simultaneously machines for both carton and PET packaging. Moreover, the PET system could be used for packaging many of the products manufactured in carton. Nevertheless, the Commission had failed to demonstrate the incentive of the entity to engage in the leveraging. Because PET is considerably more expensive than carton and customers would consider switching only if the prices of carton increased by 20 per cent or more, the merger would not give Tetra the economic incentive to bundle PET and carton equipment and to offer lower prices on the bundle.

The Court further established that the Commission had not sufficiently considered the commitments offered by Tetra, clearly indicating its willingness to comply with the Community competition rules. Moreover, the Commission had not considered the extent to which the incentives of the merged entity would be reduced, or even eliminated, owing to the illegality of the conduct in question. The Court particularly pointed out the possible deterrent effect of Article 82 EC.

### 3.3 GE/Honeywell

In July 2001, the Commission adopted the decision to oppose the acquisition of Honeywell International Inc. by General Electric Company. The Commission based its findings on horizontal and vertical as well as conglomerate effects. The parties applied in separate for a review to the CFI and the long-awaited rulings came in December 2005.

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71 Id., para. 151.
72 Id., para. 155.
73 Id., paras. 197-198.
74 Id., para. 221.
75 Id., paras. 158-159.
GE and Honeywell are both large, international conglomerates.\textsuperscript{77} The merger affected a number of markets, of which several were markets for avionics equipment (systems essential to flying, such as autopilot and navigation systems) and non-avionics (systems for, \textit{e.g.}, lighting and air-conditioning). Honeywell held a leading position in most of the avionics markets. It held a particularly strong, although not dominant, position in non-avionics. Most importantly, Honeywell was the only supplier with a significant presence in all of the non-avionics markets, giving it advantages in technical integration and the ability to offer packaged deals.\textsuperscript{78} GE was not active in either avionics or non-avionics, but it was present in several markets for jet engines. It held a dominant position in the market for large commercial aircraft engines, in which Honeywell was also present.\textsuperscript{79}

\subsection*{3.3.1 Alleged leveraging practices}

The Commission found that, post-merger, leveraging would be achieved through both pure and mixed bundling of GE engines together with Honeywell avionics and non-avionics. Moreover, technical bundling would take place in the form of a closer integration between engines and avionics equipment.\textsuperscript{80} Because engines and avionics are complementary products, both necessary for the functioning of aircrafts, the Commission foresaw that a merged GE/Honeywell entity would be both able and likely to sell larger quantities of avionics by means of bundling. As a consequence, a dominant position would be created for Honeywell in the markets for avionics and non-avionics and GE’s dominant position in the market for large commercial jet aircraft engines would be strengthened.\textsuperscript{81} The parties offered structural and behavioural commitments, both of which were rejected by the Commission.

\subsection*{3.3.2 The judgment of the CFI}\textsuperscript{82}

The Commission’s prohibition decision was ultimately upheld by the CFI. However, it was the horizontal effects and not the predicted leveraging practices that caused the Courts’ dismissal of GE’s application. By contrast, the Court found manifest errors of assessment in the Commission’s examination of leveraging. The Commission had not produced \textit{convincing evidence} of how bundling would actually occur. The Court again stressed that the Commission must prove the \textit{ability} and the \textit{likelihood} of the entity

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{77} Howarth, 2006, p. 485.
\item \textsuperscript{78} Case COMP/M.2220 General Electric/Honeywell, OJ 2004 L 48, paras. 242-243.
\item \textsuperscript{79} \textit{Id.}, para. 83.
\item \textsuperscript{80} \textit{Id.}, paras. 350-355, 412-416 and 443-444.
\item \textsuperscript{81} \textit{Id.}, para. 458.
\item \textsuperscript{82} Case T-210/01 General Electric Company \textit{v} Commission [2005], nyr. The twin case T-209/01 Honeywell \textit{v} Commission [2005], nyr, was dismissed by the CFI as inadmissible on procedural grounds.
\end{itemize}
\end{footnotesize}
using the advantage to engage in conduct that would create or strengthen a dominant position in the relatively near future.\(^8^3\)

Regarding the alleged tying, the Court noted that, although such a strategy was theoretically possible, the Commission had failed to produce sufficient evidence of the economic incentive for GE/Honeywell to engage in the alleged activities.\(^8^4\) Moreover, pure bundling would violate Articles 81 and 82 EC and the Commission had failed to consider the deterrent effect of the conduct’s illegality.\(^8^5\) The CFI also rejected the likelihood of technical bundling, as the Commission had merely raised this as a hypothetical question.\(^8^6\) Finally, the Court rejected that mixed bundling was likely. The Commission had presented evidence to show that Honeywell had previously bundled avionics with non-avionics. However, this had little relevance to the bundling of engines with avionics, on which point the Commission’s evidence was limited. By contrast, GE led extensive economic evidence to show that mixed bundling was not likely.\(^8^7\)

The Court stressed that, as established in Tetra/Sidel, the Commission was required to investigate whether the commitments offered by the parties had a deterrent effect on the parties’ behaviour. However, as the Court found that the Commission had failed to establish that the merged entity would engage in bundling, it did not examine the Commission’s treatment of the commitments relating to the conglomerate part of the case.\(^8^8\)

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\(^8^3\) T-210/01 General Electric Company v Commission [2005], nyr, paras. 386-388.
\(^8^4\) Id., para. 426.
\(^8^5\) Id., para. 425.
\(^8^6\) Id., para. 430.
\(^8^7\) Id., paras. 439 and 443.
\(^8^8\) Id., para. 472.
4 Requirements I and II: Ability and incentive

As is evident from the Tetra/Sidel and GE/Honeywell rulings, it is not an easy job for the Commission to prove leveraging in merger cases. It has been suggested that the two judgments could be interpreted as moving the European law closer to the US position, where conglomerate mergers are legal \textit{per se}.\textsuperscript{89} However, this is not the intention of the Community Courts, continually stressing that the form of the merger is not determinative for the competition assessment.\textsuperscript{90}

The detrimental effect of leveraging on competition will be examined in chapter 5. The present chapter deals with the Courts’ requirements for the ability and the incentive of the entity to be proved. As will be seen, a number of factors affect the assessment. To start with, the quality of the evidence is a key issue when establishing the incentive of the merged entity.

4.1 Standard of proof

As in conglomerate-type mergers “the chains of cause and effect are dimly discernible, uncertain and difficult to establish”\textsuperscript{91}, the Commission must produce “convincing evidence”\textsuperscript{92} of the merged entity’s incentive to engage in leveraging. Thus, it cannot assume that leveraging will occur post-merger whenever the parties possess bundling possibilities. Nor can the Commission rely exclusively on evidence of the past conduct of the parties.\textsuperscript{93}

The evaluation of proof in merger cases is indeed a problematic issue. Being a prognostic analysis, the future market outcomes and the future behaviour of the parties are irreducibly uncertain. This is particularly true regarding conglomerate mergers, which do not immediately create a SIEC. Thus, the necessity of “convincing evidence” is understandable.

\begin{footnotesize}
\begin{enumerate}
\item Case C-12/03 P Commission v Tetra Laval BV [2005] ECR I-987, para. 44.
\item Case T-210/01 General Electric Company v Commission [2005], nyr, para. 332.
\end{enumerate}
\end{footnotesize}
4.1.1 Convincing evidence

What is then convincing evidence? On a purely semantic level, the word “convincing” does not illustrate well the quality of the evidence itself, but rather the effect it has on the decision-maker. Moreover, the requirement that evidence be convincing can be regarded as self-evident. This was noted by the President of the CFI, stating in a personal capacity: “No one…would require that the Community Courts base their analysis on evidence that is not convincing!” The CFI gave some examples in GE/Honeywell of what may constitute convincing evidence. In principle, it could consist of documents showing the settled intention of the board, or of economic assessment showing that the merged entity would have the “objective incentive” to engage in the conduct.

It has been suggested that it is the likelihood of leveraging rather than the convincingness of the evidence that should be evaluated. The CFI expressed in Tetra/Sidel that conglomerate mergers may be prohibited where the Commission is able to conclude that a dominant position would, “in all likelihood”, be created. However, regardless of whether it is the convincingness or the likelihood that should be assessed, Tetra/Sidel and GE/Honeywell provide little guidance as to the general standard of proof.

4.1.2 A higher standard of proof?

Several commentators have discussed whether there is a higher standard of proof in merger cases following the two cases. In its appeal of Tetra/Sidel, the Commission particularly argued that the CFI, by requiring convincing evidence, applied a standard that was higher than that of a “cogent and consistent body of evidence” formulated by the ECJ in Kali & Salz. The Commission argued that Article 2(2) and (3) of the Merger Regulation imposes a double obligation on the Commission: to clear the concentration if it does not lead to a SIEC, and to prohibit it if it does. Advocate General Tizzano suggested instead that the Commission should only prohibit a concentration if it “very probably” leads to a SIEC. However, the ECJ stated that the CFI by no means added a condition relating to the

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98 Prete and Nucara, 2005, p. 703.
101 Case C-12/03 P Commission v Tetra Laval BV [2005] ECR I-987, para. 27.
102 Id., para. 29.
requisite standard of proof, but merely drew attention to the essential function of evidence.\footnote{Case C-12/03 P Commission v Tetra Laval BV [2005] ECR I-987, para. 41.}

Thus, according to the ECJ, the same standard of proof applies – and it applies to all types of merger.\footnote{The same conclusion has been deducted from the judgment by, e.g., Käseberg, 2006, p. 421 and Prete and Nucara, 2005, pp. 696-698.} Nevertheless, the ECJ highlighted the particular difficulties inherent in proving a leveraging theory and supported the CFI’s intensive review of the Commission’s evidence.

In my opinion, the message from the Courts is not entirely comprehensible. The CFI has recognised that conglomerate mergers are generally considered neutral or beneficial, and that convincing evidence is required when alleging the opposite.\footnote{Case T-5/02 Tetra Laval BV v Commission [2002] ECR II-4381, para. 155.} This implies that the quality of proof is particularly important in conglomerate cases (or, possibly, that there should be a presumption of legality for such mergers). Conversely, the ECJ refutes that there is a higher standard of proof in conglomerate-type mergers.

It could be the nature of leveraging cases that makes it particularly difficult for the Commission to produce convincing evidence or prove the likelihood of leveraging.\footnote{Käseberg, 2006, p. 422.} The conditions leading to a SIEC vary between different types of merger: whereas the circumstances in, e.g., a horizontal merger may directly lead to a SIEC, conglomerate mergers may lead to a SIEC only after a certain time. Given this view, the discrepancy does not lie in the standard of proof required, but in the pre-merger conditions under which the Commission must meet the standard of proof.

4.1.3 Economic evidence

In \textit{GE/Honeywell}, the CFI devoted the economic analysis a heading under which it examined the different economic models put forward by the parties. The Court stated that, in the absence of company documents supporting a leveraging strategy, the Commission needs to present an economic analysis that is closely tied to the facts at hand and not limited to invoking general economic theories. It then concluded that the Commission had failed to present such an analysis.\footnote{Case T-210/01 General Electric Company v Commission [2005], nyr, paras. 444-462.}

Whilst showing its willingness to engage in a discussion on economic theory, the Court emphasised that economic theory is neither sufficient nor always necessary in order to prove leveraging. Where an issue relating to dominance can be established by direct fact evidence, economic theory may be eclipsed.\footnote{Howarth, 2006, p. 492.} The CFI held that “arguments based on the allegedly unorthodox nature, in terms of economic theory, of the Commission’s case
cannot prevail over the convincing evidence adduced by the Commission.”110 Hence, while a more economic approach to competition law is favoured, economic theory is not a substitute for empirical evidence.

It is uncertain how the Courts would react should there be a “battle between economists”. Indeed, making complex economic assessments is normally the task of the Commission’s experts. The Community Courts are empowered by Article 230 EC to review the legality, but not the merits, of the Commission’s decisions. It is settled case law that for the appraisal of economic facts, the Commission enjoys a certain margin of discretion which the Courts must respect.111 A contrast can be drawn between the role of the Courts in US antitrust with that in EC competition law. Whereas in the US, the courts act as the true arbiter for the case in which the competition authority must make its case, the European Courts only play a role if the parties appeal a decision made by the Commission.112 In case of such an appeal, the Courts’ review is to some extent limited by the Commission’s scope of discretion.

In its appeal of Tetra/Sidel, the Commission argued that the CFI had not given sufficient weight to its margin of discretion. The CFI replied: “Not only must the Community Courts, inter alia, establish whether the evidence relied on is factually accurate, reliable and consistent but also whether the evidence contains all the information which must be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn from it.”113

Merger assessment demands interaction of facts, law and economic theory. As a result of this, the lines between the different review functions are not always clear.114 Whilst the Commission enjoys a margin of discretion in carrying out economic assessment, the Courts after appeal cannot refrain from evaluating the evidence relied on by the Commission. In a great number of merger cases, this will include economic evidence.

4.2 Relevance of behavioural commitments

When examining the likelihood of leveraging, the Commission must take into account two factors which may reduce or eliminate the merged entity’s incentive to engage in the activities: 1) the behavioural commitments by the


merging parties to refrain from the conduct\textsuperscript{115} and 2) the potential illegality of the conduct, in particular that under Article 82 EC\textsuperscript{116}. The latter will be discussed under 4.3.

In \textit{Tetra/Sidel}, the Commission stated that the behavioural commitments offered by Tetra constituted little more than a promise, not resolving the structural problems following the merger. Moreover, those commitments would be too burdensome for the Commission to monitor. The CFI held that commitments cannot be rejected by the Commission solely on the basis that they are behavioural and not structural. According to the Court, Tetra’s commitment meant that no joint offers of carton packaging and PET packaging equipment would be made. This effectively eliminated the means by which the merged entity might have tried to leverage its dominant position in carton: the possible means of leveraging would have been “quite limited” post-merger.\textsuperscript{117}

In \textit{GE/Honeywell}, the Commission likewise found that a commitment not to bundle was a pure promise and thus ineffective.\textsuperscript{118} The CFI did not examine the Commission’s assessment of the commitments in the conglomerate part of the case. However, considering the Courts statement in \textit{Tetra/Sidel}, it would not be too challenging to predict that the Commission was wrong in dismissing the behavioural commitments without further investigating their efficiency.

A number of authors welcome the Courts’ criticism of the Commission’s quick dismissal of behavioural commitments.\textsuperscript{119} Since the Commission bases its findings on leveraging on the likely future conduct of the parties, structural remedies may be ill-suited to address leveraging concerns. For instance, it is unclear just how much market share must be divested in order to tip the balance towards the presumption that the merged entity would no longer have the incentive to leverage.\textsuperscript{120} In such a case, a behavioural commitment would be a more suitable and proportionate remedy. Moreover, where the likely future conduct of the merged entity is what decides whether it should be cleared or prohibited, it would be inappropriate not to take into consideration commitments which accurately address the parties’ future conduct.\textsuperscript{121}

\begin{footnotesize}
\begin{enumerate}
\item[\textsuperscript{115}] Case C-12/03 P Commission v Tetra Laval BV [2005] ECR I-987, paras. 85-89.
\item[\textsuperscript{116}] Case C-12/03 P Commission v Tetra Laval BV [2005] ECR I-987, para. 74; Case T-210/01 General Electric Company v Commission [2005], nyr, paras. 70-75.
\item[\textsuperscript{117}] Case T-5/02 Tetra Laval BV v Commission [2002] ECR II-4381, para. 224.
\item[\textsuperscript{118}] Case COMP/M.2220 General Electric Company/Honeywell, OJ 2004 L 48, para. 531.
\item[\textsuperscript{119}] See, \textit{e.g.}, Prete and Nucara, 2005, p. 703; Völcker, 2003, pp. 609-611; Käseberg, 2006, p. 403.
\item[\textsuperscript{120}] Völcker, 2003, p. 609.
\item[\textsuperscript{121}] Prete and Nucara, 2005, p. 703.
\end{enumerate}
\end{footnotesize}
4.2.1 Deterrent effect?

Although the Courts have recognised the validity of behavioural commitments in principal, it is not clear to which extent such commitments may effectively eliminate a competition problem. Can a “pure promise” achieve this? A number of commentators believe that well designed behavioural commitments should remedy the majority of the Commission’s leveraging concerns.\(^\text{122}\) It has even been suggested that, absent special circumstances, there should normally be a presumption that behavioural commitments are effective in eliminating the risk of leveraging.\(^\text{123}\)

Nevertheless, there are difficulties inherent in assessing the deterrent effect of commitments. The effect of a behavioural commitment depends on the ability of the Commission to monitor the merged entity’s compliance. Moreover, it depends on the commitment’s effectiveness, \textit{i.e.} its capacity to remedy the competition problem at hand.\(^\text{124}\)

Whilst it is true that behavioural commitments may be difficult for the Commission to monitor, it must be questioned whether such concerns should be a burden of the merged entity. In my opinion, it would be inappropriate for the Commission to reject a commitment on the sole ground that it would be excessively burdensome to police the firm’s compliance. This view is further supported by the Merger Regulation, which obliges the merged entity to comply with the commitments attached to the decision. Should it fail to do so, the Commission may withdraw the merger clearance. Although it is not certain that a withdrawal would remedy the harm already caused to competition, the threat of the Commission withdrawing its clearance would in any event appear to be a disincentive to engage in leveraging. Moreover, it could be added that a modified concentration is subject to the same criteria as an unmodified concentration.\(^\text{125}\) Accordingly, the Commission has the burden of showing the emergence of a SIEC and cannot evaluate a commitment on the assumption that the parties carry the burden of proof for its effectiveness.

Evidently, it is not certain that \textit{any} type of commitment may remedy a competition problem – this depends on the capacity of the specific commitment to remedy the specific competition problem. However, in my view, where a commitment has this capacity, monitorability concerns should not stand in the way.

\(^{122}\) See, \textit{e.g.}, Prete and Nucara, 2005, p. 703; Völcker, 2003, pp. 609-611.
\(^{123}\) Völcker, 2003, p. 611.
\(^{124}\) Käseberg, 2006, p. 418.
\(^{125}\) Case T-87/05 Energias de Portugal SA v Commission [2005], nyr, para. 62.
4.3 Relevance of Article 82 EC

When relying on foreseeable conduct which in itself is likely to constitute abusive conduct, the Commission must assess whether the illegal nature of the conduct will reduce, or even eliminate, the incentive of the merged entity. However, the examination is limited: the Commission is not required “…to examine, for each proposed merger, the extent to which the incentives to adopt anti-competitive conduct would be reduced, or even eliminated, as a result of the unlawfulness of the conduct in question, the likelihood of its detection, the action taken by the competent authorities, both at the Community and national level, and the financial penalties which could ensue.”

Hence, although the Commission is required to take into account the illegality of the conduct as a deterring factor, it does not have to go as far as to speculate about the extent to which illegality could reduce the incentives. Moreover, it does not have to examine the probability of the detection of the conduct and of the enforcement of Article 82 EC. Even so, the CFI established in GE/Honeywell that the Commission’s examination of a proposed merger includes taking into account the likelihood that the conduct would be punished. The Commission itself takes the same position, establishing in the Draft Guidelines that it will consider in particular the likelihood that the illegal conduct could be detected and the penalties which could be imposed.

Considering the fast-track procedure laid down in the 2004 Merger Regulation, the ECJ’s statement in Tetra/Sidel is logical. In my view, it would be unreasonable for the Commission to carry out extensive Article 82 investigations during a merger process. A procedure similar to that under Article 82 EC would be difficult to pursue within 90 days and could affect the efficiency of merger control. Moreover, as has been pointed out, the obligation to carry out an analysis of the factors enumerated by the ECJ for each case would be excessively burdensome for the Commission. Nevertheless, the GE/Honeywell judgment implies that the obligation of the Commission to take Article 82 EC into account is rather far-reaching.

References:
126 Case C-12/03 P Commission v Tetra Laval BV [2005] ECR I-987, para. 74.
128 Case T-210/01 General Electric Company v Commission [2005], nyr, paras. 75-76.
129 The Draft Guidelines, para. 44. See also Case COMP/M.3440 ENI/EDP/GDP, Commission decision of 9 December 2004, para. 382 (where the Commission took into account the likelihood that the foreclosing conduct would be detected by national authorities).
4.4 Concluding points

The Merger Regulation does not preclude a prohibition decision based on leveraging arguments. It is however inherently difficult to prove leveraging, since the analysis must rely on the plausible future behaviour of companies. In principle, the Commission must deliver “smoking gun” evidence of the board’s settled intention to implement a strategy. The Courts may also accept the economic assessment of the Commission, if it is closely linked to the facts and supports the entity’s objective incentive to engage in leveraging. In making the assessment, regard must be had not only to incentives but also to disincentives of the parties to engage in leveraging, including the risk that the behaviour would be illegal under Article 82 EC. Moreover, the parties’ behavioural commitments may reduce or eliminate the ability and the incentive of the parties to engage in leveraging.
5 Requirement III: SIEC

Should it be proved that the merged entity would have the incentive and the ability to engage in leveraging, it must in addition be established whether the behaviour would lead to the emergence of a SIEC. In other words, it must be examined whether the bundling would in effect lead to a sufficient competitor foreclosure, causing consumers harm in the end. This includes an examination of the objective market conditions, including e.g. market growth and the rational choice of customers.

5.1 Relatively near future

In Tetra/Sidel, the CFI drew a basic distinction between situations where a conglomerate merger immediately results in the creation or strengthening of dominance and situations where the creation or strengthening of dominance does not immediately result from the merger, but will occur after a certain time and will result from the conduct engaged in by the merged entity where it already holds a dominant position.

As discussed under 4.2.2, it is particularly difficult for the Commission to produce convincing evidence where a SIEC is not created immediately post-merger. Since a SIEC in a leveraging case would emerge only after a certain time, the Commission’s analysis of the future position of such an undertaking must be particularly plausible. Moreover, it must be shown that a SIEC will be created “in the relatively near future”. The Courts have not laid down a specific time frame within which a SIEC must be created. However, the Tetra/Sidel judgment may be read as suggesting that a three-year time frame would be acceptable.

In assessing the effects on competition, countervailing factors such as buyer power or the likelihood that entry would maintain effective competition shall be taken into account. Further, the effects on competition shall be examined in the light of the efficiencies substantiated by the parties.

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133 Id., para. 162.
135 Id., paras. 211-216, 239.
136 The Draft Guidelines, paras. 112-113.
5.2 Competitor foreclosure

The core of the leveraging theory is the competitor foreclosure to which the activities are predicted to give rise. It is only where a sufficiently large fraction of market output is affected by foreclosure resulting from the merger that a SIEC may be created.\footnote{Id., para. 111.} Where leveraging has the potential of redirecting sales to the merged entity, its effects may be limited if one or more competitors can offer a similarly broad portfolio.\footnote{See, e.g., Case COMP/M.3304 GE/Amersham, Commission decision of 21 January 2004, para. 39.} Even where the breadth of the portfolio is unmatched, competitors with narrower product ranges may be able to counterpart the entity’s advantages through alliances (‘teaming’) of mergers.\footnote{Völcker, 2003, p. 604.}

In Tetra/Sidel, the CFI established that a large part of the customer base for PET packaging machines had no demand for Tetra’s carton packaging system. Since rivals would still have access to large parts of the market, the impact of leveraging would not be sufficient.\footnote{Case T-5/02 Tetra Laval BV v Commission [2002] ECR 4381, para. 278.} Hence, the links between the two markets were not strong enough for the alleged bundling to cause sufficient competitor exit.

Rather than competitor exit, the recent Draft Guidelines point out entry barriers as the main concern of leveraging strategies. By reducing sales prospects for potential rivals in that market to a level below minimum viable scale, the foreclosure practices may deter entry by potential competitors.\footnote{The Draft Guidelines, para. 110.}

The CFI’s statement in Tetra/Sidel implies that a merger is unlikely to produce adverse effects if effective single-product actors remain in either market. Indeed, even with high entry barriers, competition post-merger may be strong.\footnote{Bishop and Walker, 2002, p. 298.} If a number of firms are fighting vigorously in the market pre-merger, and it can be concluded that the merger will not lead to competitor exit, possible barriers of entry should be of less importance.\footnote{See, e.g., Völcker, 2003, pp. 602 and 605 (holding that a sufficient number of competitors must exit, and be unable to re-enter, the relevant market in order for the foreclosure to be sufficient).}

The approach of the Commission clearly reflects the difference between the pure dominance test and the SIEC test. In Tetra/Sidel, the creation or strengthening of a dominant position had to be shown in order for the leveraging to be deemed harmful. This could not be achieved without sufficient competitor exit. Under the SIEC test, however, the absence of entry is in itself regarded as a competition problem capable of creating a SIEC. This makes sense, given the fact that merger assessment shall take
into account “the need to maintain and develop effective competition.”

High entry barriers may well hinder the development of competition.

### 5.3 Efficiency: Defence or offence?

Conglomerate mergers may in a number of cases produce immediate efficiencies. Where the efficiencies are likely to enhance the ability and the incentive of the merged entity to act pro-competitively for the benefit of consumers, the Commission may declare the merger compatible with the Common market.

However, it is in effect hard for the parties successfully to bring to light the efficiencies of the merger and there is a risk that the Commission will interpret them negatively. An attempt by the merging parties to establish an efficiency defence may be translated into an efficiency “offence”, i.e. as a ground for prohibiting the merger. Strategies leading to a reduction in prices may be deemed to have an exclusionary effect. This was the case in GE/Honeywell, where the Commission predicted that GE might offer package discounts to customers who buy both GE engines and Honeywell products. The Commission did not allege predatory pricing, but feared that the package discounts would in any event threaten the future of competitors. Thus, whilst a price decrease may be accepted as a “good” efficiency, this is not the case where the price decrease is deemed to have an exclusionary effect.

When assessing a finely balanced case, the Commission must look to wide EC objectives. This includes, e.g., the completion of the internal market and the need to maintain and develop effective competition. Presumably, this is the main difference between the economic and the legalistic approaches to competition law. From the economic perspective, the goal is efficiency, not competition in itself. From the legalistic perspective, vigorous competition may in itself be an objective meriting protection. The US approach to efficiencies differs considerably from the EU approach. Economic theory has had a significant impact on the legalistic approach to competition, which does not embrace “wider objectives” than that of efficiency.

In effect, the Commission has been criticised for allowing politics and industrial policy to creep into merger control. For instance, in the

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144 The Merger Regulation, Article 2(1)(a).
149 The Merger Regulation, Recitals 3, 4 and 23.
Boeing/McDonnell Douglas\textsuperscript{152} merger, the fragility of McDonnell’s position and its low market share in large civilian jet aircraft might well have justified a clearance. Instead, the Commission sought commitments from Boeing to end its exclusivity agreements with major airlines. Cynics say that this had more to do with protecting Airbus than protecting consumer welfare.\textsuperscript{153}

### 5.4 Competitor foreclosure v consumer benefit

A number of commentators have emphasised that more weight should be given to the short-term benefits resulting from conglomerate mergers.\textsuperscript{154} From an economic perspective, it may well be that the instant decrease in prices resulting from the merger outweighs the loss resulting from the higher prices after successful competitive foreclosure.\textsuperscript{155} Where this is the case, the tying or bundling would not be condemned from a consumer welfare perspective.

The Merger Regulation contains no balancing exercise to be performed between adverse effects on competition and consumer benefits (such as that contained in the SLC test or under Article 81(1) and (3) EC). Although efficiencies are to be taken into account if they fulfil the requirements, they cannot “make up” for the competitor foreclosure identified. Moreover, the Commission is required to assess the effects of a merger in a prospective analysis. It could be that the price reduction or output expansion immediately following the merger will be of short duration and that consumer welfare will ultimately suffer, as a consequence of the competitor foreclosure.

Then, to which extent may consumer benefit be taken into account? Whilst the widening of the compatibility test in theory should also increase the scope for recognising efficiencies resulting from a merger, the circumstances will be rare in which efficiencies have a positive, decisive influence on the Commission’s decision.\textsuperscript{156} The EAGCP’s merger subgroup emphasised in 2006 that the coming Non-horizontal Guidelines should have a clear focus on competitive effects resulting in consumer benefit and not on harm to competitors.\textsuperscript{157} However, the Draft Guidelines speak little of

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\textsuperscript{152} Case IV/34 Boeing/McDonnell Douglas, OJ 1991 L 334/42.

\textsuperscript{153} Cook and Kerse, 2005, p. 272. See also Burnside, 2002, p. 109 (criticising the excessive weight given to competitors’ concerns in the Commission’s GE/Honeywell decision).

\textsuperscript{154} See, e.g., Völcker, 2003, pp. 587-588; Pflanz and Caffarra, 2002, p. 117.

\textsuperscript{155} Völcker, 2003, p. 607.

\textsuperscript{156} Cook and Kerse, 2005, pp. 274-275.

consumer benefit. As regards efficiencies, they state nothing new but refer to Section VII of the Horizontal guidelines.\textsuperscript{158}

In conclusion, the SIEC test allows for a wider assessment of the overall effects on competition. The test does however not appear to provide a wider scope for taking efficiencies into account – a presumption supported by the recent Draft Guidelines. This leads to the conclusion that it is less problematic to fulfil the third part of the leveraging test under the SIEC test than it was under the pure dominance test.

Whilst it would in my opinion be improper to introduce a balancing test (because wider objectives than that of economics must be taken into account), the scope for taking efficiencies into account should be widened in conglomerate mergers. Currently, however, the efficiency issue is of a mainly theoretical interest in leveraging cases. The Courts have never reached the third part of the test, since the Commission has committed manifest errors in assessing the ability and incentive of the merged entity. Thus, in effect the assessment is moving closer towards the US approach: legality \textit{per se} for conglomerate mergers.

\textsuperscript{158} The Draft Guidelines, fn. 90.
6 Would Article 82 EC suffice?

The CFI stated in *Tetra/Sidel* that most of the leveraging relied upon by the Commission – including tying or bundling carton and PET products – “would usually constitute an abuse” of Tetra’s dominant position in carton. The Commission had not considered whether the illegality would have reduced or eliminated the likelihood that leveraging would occur. Accordingly, the Court did not consider the effects of possible abusive conduct, but took into account only the forms of leveraging that would most likely be legal. This raises the question of whether Article 82 EC would in effect cover the majority of leveraging practices examined in merger cases.

The advantages of the *ex post* examination have been pointed out by commentators. For instance, a wait-and-see approach would allow the competition authority to see whether the alleged practices actually occur and whether they are *prima facie* exclusionary or efficiency enhancing. According to the Advocate General in *Tetra/Sidel*, the *ex post* examination of leveraging would limit the costs of false clearance decisions. Moreover, as opposed to the fast-track merger procedure, Article 82 EC would allow the Commission to investigate extensively the possible effects of leveraging on competition.

6.1 Exclusionary conduct under Article 82 EC

It has been pointed out that the majority of the potential post-merger conduct which may lead to a SIEC should be covered by Article 82 EC. Tying is explicitly prohibited under Article 82(d) EC. The *Hoffman-La Roche* ruling implies that also mixed bundling may constitute an abuse under Article 82 EC. The ECJ found that the grant of discounts by a dominant firm which were conditional on the customer purchasing the whole range of the firm’s products was abusive. Technical bundling, lastly, may also be caught by Article 82 EC. This would be the case where the practice in question involves making the merged parties’ products incompatible with those of competitors.

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159 Case T-5/02 Tetra Laval BV v Commission [2002], ECR II-4381, para. 159.
160 Id., para. 162.
However, the application of Article 82 EC would not always be uncomplicated, as the leveraging practice in question could be objectively justified. Tying may be excluded where the products by their nature and according to their commercial use have a sufficient connection. In *Tetra Pak II*, Tetra claimed that this type of connection existed between the two products, justifying the tie.

Moreover, although Article 82 EC should in principle address the types of conduct predicted in merger cases, it is not sure that the conduct would be illegal under this Article. In its discussion paper on the application of Article 82 EC to exclusionary abuses, the Commission has set out a three-step test for exclusionary behaviour to be illegal under Article 82 EC: 1) the conduct must have the capability, by its nature, to foreclose competitors from the market; 2) a likely market distorting foreclosure effect must be established; and 3) the conduct itself must neither be objectively justified nor must its negative effects be outweighed by efficiencies.

It is well established that leveraging may result in foreclosure effects. In the context of Article 82 EC, foreclosure is defined as market distorting if it likely *hinders the maintenance of the degree of competition still existing* in the market or the *growth of that competition* and thus has as a likely effect that *prices will increase or remain at a supra-competitive level*.

Hence, exclusionary conduct under Article 82 EC must lead to increased prices in order to be market distorting. In merger cases, however, the main concern is competitor foreclosure rather than increased prices. In a case where the conduct would not result in competitor exit, but only in, e.g., high entry barriers, it is not sure that the exclusionary behaviour would lead to increased prices. The foreclosure could nevertheless be sufficient in order to create a SIEC under the Merger Regulation.

Moreover, for tying or bundling to be abusive under Article 82 EC, the company concerned must be dominant in the tying market. In leveraging cases, dominance is not a prerequisite for the emergence of a SIEC. For the foreclosure to give rise to concern, the new entity, prior to it engaging in exclusionary practices, must have “market power” in one of the markets concerned. Accordingly, there should be a number of cases where the conduct predicted pre-merger would not be illegal by Article 82 EC post-merger.

As pointed out by the Commission, Articles 81 and 82 EC could indeed be promoted in every merger case. However, if those Articles sufficed in order
to deter from certain conduct, then there would never be a need for an *ex ante* control of mergers.\footnote{Case C-12/03 P Commission v Tetra Laval BV [2005] ECR I-1113, para. 59.} The framework of the Merger Regulation is distinct from that of Article 82 EC: whereas Article 82 EC prohibits the abuse of a dominant position, the aim of the Merger Regulation is to hinder the emergence of a SIEC. This is not necessarily the result of abusive behaviour, nor of the creation or strengthening of dominance.

Still, no case of leveraging has been successful under the Merger Regulation thus far. Considering this, and the merits of the *ex post* examination described above, it is not impossible that the Commission’s focus will shift to the *ex post* examination of (abusive) leveraging strategies.
7 Concluding remarks

7.1 The applicability of the theory

In conclusion, the leveraging theory has proved to be an inefficient tool in fighting potentially harmful mergers; the circumstances under which the Merger Regulation would allow blocking a merger on grounds of leveraging are very rare. Firstly, there are evidentiary concerns inherent in the prediction of the parties’ future conduct. Secondly, the possibility of proving leveraging is reduced by the fact that regard must be had to the Article 82 remedies which might ensue post-merger. The extent to which illegality under Article 82 EC must be taken into account is somewhat uncertain. However, the *GE/Honeywell* ruling implies that the risk of Article 82 remedies reduces to a considerable extent the scope of taking activities into account in the *ex ante* examination of a merger. Lastly, the ability of the merged entity to engage in leveraging may be reduced or eliminated where the entity offers a commitment not to engage in the alleged behaviour.

The SIEC test calls for a broad assessment of the effects on competition, taking not only the creation or strengthening of dominance into account. However, the test does not provide a wider scope for taking efficiencies into account. Several commentators have discussed this, underlining the significant consumer benefits normally arising from conglomerate mergers.

The standard applied in *Tetra/Sidel* and *GE/Honeywell* is so stringent that there is little practical difference between that standard and a rule recognising the *per se* compatibility of conglomerate mergers with the common market. Although it should in principle be less difficult to fulfil the last part of the leveraging test today, the high requirements for proving the ability and incentive will rule out a prohibition decision in the majority of cases. Thus, the approach of the EU is in effect getting closer to the US approach. However, as pointed out by Kolasky\(^\text{174}\), the *GE/Honeywell* ruling narrows, but does not close, “the gap” – conglomerate mergers will still be under examination in the EC merger framework. It is not impossible that additional theories addressing such mergers will be developed. The change from the pure dominance test to the wider SIEC test supports this view.

7.2 Should leveraging be investigated in a merger context?

There are advantages with the *ex post* examination of leveraging. Most importantly, a post-merger procedure would eliminate the element of uncertainty when examining the behaviour of the parties. However, the *ex*  

\(^{174}\) Kolasky, 2006.
post application of Article 82 EC would not remedy the Commission’s leveraging concerns in every case. Conduct which would not lead to increased prices or maintenance of prices at a supra-competitive level would not be abusive under Article 82 EC. However, such conduct may well lead to the emergence of a SIEC under the Merger Regulation.

It is nevertheless a fact that a prohibition decision on grounds of leveraging has never been accepted by the Community Courts. Considering the outcomes of Tetra/Sidel and GE/Honeywell, the Commission might be expected to focus on the ex post examination of leveraging, i.e. to focus on leveraging strategies which are abusive.
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