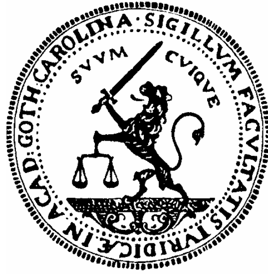

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A Market Worth Monopolising

Investigating Market Power after Recent EC Merger Cases

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Summary

In theory, a perfectly competitive market is a market where there are many suppliers of products, their products are substitutable, all suppliers are price-takers and not price-makers, and there are no significant barriers to market entry. The opposite of perfect competition is total market domination, or monopoly. That is a market where there is only one supplier of products and where significant barriers to market entry exist. The monopolist can set the price and produce the quantities of products it chooses.

The EC competition policy strives at maintaining a "healthy" or "workable" competition on the market, i.e. a state closer to perfect competition than to monopoly. The Commission, and on appeal the EC Court of First Instance, has the power to assess whether to allow a notified merger or not.

When a merger between large undertakings is evaluated under EU competition law, it is necessary to determine the impact of the merger on consumers and competitors. If the merged entity will be dominant, i.e. holds enough market power to act independently from its competitors, the merger should not be allowed.

When determining whether a possible merged undertaking will have enough market power to dominate the market it is necessary to define the relevant market on which the merged entity would operate. After such definition, the resulting market power of the merged undertaking is estimated. The Commission will have to assess whether the merger will result in negative consequences on competition on the market.

In recent case law, notably the Airtours-, Schneider Electric-and Tetra Laval-cases respectively, the EC Court of First Instance did not accept the assessment of the Commission and its findings of market power. This has lead to a discussion of burden of proof imposed on the Commission, but also to the discussion about collective dominance (in markets of oligopoly) and leveraging.

The cases prove that, in the future, the burden of proof laid on the Commission is substantial. Because of this, the need for complex econometric investigation of the merging undertakings has increased substantially. Therefore, it can be expected that the Commission will require merging undertakings to supply more extensive economic data at the outset of merger review in the future.

In this thesis we examine the concept of market power under EC law, in the light of the recent case law from the Court of First Instance. Because of the emphasis on economics and econometrics in future merger analysis a number of theories and techniques are presented that we think might be useful to the Commission as well as to undertakings preparing a merger.

After analysing the referred cases it is evident that the Commission will have to, in the future, conduct a more thorough investigation of the effects of the proposed merger, and to provide both the merging parties and the Court with

substantial evidence that the proposed merger will have negative effects on competition, provided the Commission decides to prohibit the merger.

Preface

Writing this thesis has been a challenge for both of us since we have been working and writing at the same time. The challenge has been finding the time and inspiration to get the writing done. There have been times where we have constantly had a bad conscience and lack of time. When we now look in the mirror we are able to conclude that we could have got our priorities straight earlier. When we put our mind to it and took time to complete this thesis, there was both inspiring and interesting work!

Writing this thesis, we have had many friends and family members showing interest in our progress. Primarily their inquiries have been supportive in a somewhat pushy way, although always cheerful. We would especially like to thank Kristina Arvidsson who has been supporting both of us and Margareta Lönroth who has made valuable comments to parts of the text. We would also like to thank our Supervisor Katarina Olsson who has been a great inspiration to us both during our years at Juridicum.

Finally we would like to thank everybody who has been supportive in one way or the other, especially Maria Johnsson, Mats Lidgard, Hans Henrik Lidgard, Göran and Birgit Amilon, and friendly Englishman Mark Furse.

Lund, November 20, 2003

Abbreviations

CFI	The Court of First Instance of the European Communities
CMLR	Common Market Law Report
EC	European Community
ECLR	European Competition Law Review
ECR	European Court Report
EEA	European Economic Area
EEC	European Economy Community
EFTA	European Free Trade Association
OJ	Official Journal of the European Community
SSNIP	Small but Significant Non-transitory Increase in Price

1 Introduction

1.1 Background

The word *competition* emanates from the Latin word *concurrere*, which means to encounter or to race. In a competitive society this is illustrated by the competitor's struggle to get the most favourable conditions on the market. The risk is that without regulating the behaviour of undertakings, collusion between firms or even monopoly will appear.

The market is the playground where producers and distributors compete with each other to win customers and sales or to attract labour etc. In order to be competitive, an undertaking may develop and use its know-how, its products or its financial power.[1]

In the long run every undertaking strives to survive, but in a shorter perspective they are striving for profits and in order to stay alive and on the market and be profitable, they need to stay competitive.[2]

Today's society strives at finding a way to have *workable competition*, that is, a situation where the numbers of sellers are not too few, where the products are not too differentiated, where the competitors are independent of each other and where there are no relevant barriers to entry on the market.[3]

The political aims are usually to reach full employment, rapid economical growth, reasonable price stability, a balance in foreign trade and an effective allocation of the economical resources. The means used by the government and the European Union to support competition is to have a well-formulated and long-term economical policy and a workable competition policy.[4]

Effective competition will lead to economic advantages for customers and consumers[5], while anti competitive behaviour and monopolised markets will lead to economic disadvantages.

In order to maintain and develop effective competition within the EU, the Commission has been given the power to assess and control the status of a concentration and its market power. The Commission has, for example, the authority to declare a concentration incompatible with the common market, especially in case of mergers that creates or strengthens a dominant position that would impede competition on the common market. While assessing the status of a concentration and the effect a possible merger will have on competition in the Common Market, it is necessary to distinguish the relevant market and measure the market power in which the undertakings are active.

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[1] Nordell, P J., Konkurrensteori och konkurrensbegränsning, page 7.
[2] *Ibid.*, pages 16-17.
[3] *Ibid.*, page 14.
[4] *Ibid.*, page 16.
[5] Jones, C.J. and Kerse, C.S., E.C. Merger Control, page 125.

In order to decide whether the behaviour of an undertaking or a merger is compatible with the common market or not, primarily the Commission has to define the relevant market. In *Kali und Salz* the Court of Justice pointed out the importance of establishing a definition of the relevant market.[6]

There are many interesting EC merger cases that address the concept of the relevant market and market power and over the years the economical aspects of the Commission's reasoning have taken over more and more.

Econometric analysis[7] has become a very important tool in the assessment of the market power, as the Commission has to decide what future effect a notified merger will have on the market and whether competition will be impeded or not on the basis of the merged entity's position on the relevant market.

A merger in the EU meaning will occur when two or more previously independent undertakings join to create a whole new undertaking or, while they are still remaining separate legal entities, they create a single economic unit.[8] When two undertakings merge, competition on the relevant market changes and the merger might have a positive or a negative impact on this market. If the merger leads to a negative impact, the Commission has the powers of prohibiting the merger.

During the years of 1999 to 2002 the Commission has lost three merger cases; the Airtours-case, the Schneider / LeGrand-case and the Tetra Laval-case. In these cases the Commission declared the mergers incompatible with the common market thus prohibiting the mergers. The prohibition decisions were in all three cases overruled by the Court of First Instance (CFI) and the Commission's economical reasoning was heavily criticised. These cases all indicate that change is imminent. In this thesis we take a closer look at what can be expected in terms of econometric reasoning in future merger cases.

The lack of economical reasoning within the Commission has been discussed due to the outcome of these cases and this thesis will be a contribution to this discussion forum.

1.2 Purpose

Our work hypothesis is that the recent case law from the Court of First Instance has changed substantially the way markets are defined and even more how market power is estimated. More specifically we believe it has raised the Commission's burden of proof required to disallow a merger.

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[6] Joined Cases, C-68/94 & C-30/95, Kali & Salz. At para 143 the Court pointed out that "a proper definition of the relevant market is a necessary precondition for any assessment of the effect of a concentration on competition".
[7] An econometric model is an economic model formulated so that its parameters can be estimated if one makes the assumption that the model is correct. Often, this involves the study of time series such as data on price variations over time.
[8] Commission Notice on the concept of undertakings concerned under Regulation (EEC) No 4064/89 on the control of concentrations between undertakings, [1998] O.J. C66/5, para 12.

This thesis has the intention of investigating whether this hypothesis is true and also to describe the possible ways market power may be estimated in future merger cases.

1.3 Method

Since the cases we are describing in this thesis are mergers, we will give the reader a brief introduction to the definition of a merger and applicable rules on mergers. The Commission Notices of importance to interpreting the Merger Regulation and to the estimation of market power have been commented on. The concept of relevant market will also be described in the initial chapters.

Because it is important for the understanding of the outcome of some of the theoretical tests presented in this thesis, we will more thoroughly describe the notion of competition.

In practice, the Commission and merging undertakings rely on economic and econometric theories and techniques when defining markets and estimating market power. While one empirical test may be inconclusive on its own, a number of performed tests can often be supportive of one view or the other.

The presentation in the chapters that follow collects these theories in a somewhat complete toolbox, in which to begin the process of collecting evidence of the actual market power of a merging undertaking. This presentation is followed by an analysis of the three merger cases of late where the Court of First Instance has overturned the Commission's Decisions to disallow a merger.

Our conclusions follow in a separate chapter.

1.4 Materials

The Commission Decisions and the Court Judgements in the Airtours-case, the Schneider / LeGrand-case and the Tetra Laval-case has been thoroughly examined as well as any comments in relevant journals on these cases.

We have also used books of well known authors within the area of competition law and economics of competition, such as books written by Bishop and Walker, Cook and Kerse and Jones and Surfin.

The EU web site *Europa*[9] was used to gather information about the political process of reforming merger review. Furthermore, various Internet news services were used to find supplementary information about the cases presented.

[9] The Europa web site can be found at <www.europa.eu.int>

2 EU Mergers

A merger occurs when two or more previously independent entities unite and merge their businesses in one way or another.

One of the reasons for a merger is often that the undertakings will be more efficient by way of exploiting economies of scale production and other business areas. A merger could therefore lead to efficiency and economies of scale in manufacture, distribution, cost of capital and management and research and development and consequently lead to economical benefits and market growth.

2.1 Background

For an undertaking a merger may be necessary to stay competitive and in a global perspective the creation of big, monopolised European companies[10] might facilitate cross-border trade and contribute to technical and economical development in EU.[11]

The purpose of EC merger control is to preserve and promote an effective competitive structure within the common market. The Merger Regulation adopted in 1989[12] enables the Commission to prohibit mergers between undertakings that will have a negative impact on competition in the European Union. Anti-competitive behaviour between undertakings has always been opposed in the European Community and obviously a merger could lead to the same consequences on the market even in a more permanent way, as a merger results in more permanent structural changes than agreements between undertakings.[13] There is also a Commission Notice on the concept of concentration[14] with guidelines on how to assess possible merger.

2.2 Horizontal Mergers

A horizontal merger takes place where two or more market competitors are merging. This merger will lead to a reduction of the number of competitors on the market and, at least initially, to a bigger market share for the new entity than either of the competitors involved had before the merger took place. This will enable the new undertaking to unilaterally raise prices or to reduce output

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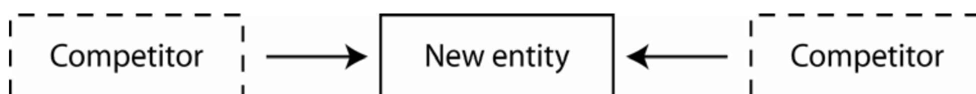
[10] The idea of big EU companies has particularly been favoured by France but has been rejected by other member states, such as Germany and the United Kingdom. These countries did not want to take the chance of allowing anti-competitive mergers only on the grounds that the merging entities could have strengthened their position in the international marketplace. Motta, M., *E.C. Merger Policy and the Airtours Case*, page 202.
[11] Jones, A. and Surfin, B., EC Competition Law, pages 700 – 701.
[12] Regulation 4064/89 [1989] O.J. L395/1.
[13] Jones, A. and Surfin, B., EC Competition Law, page 699.
[14] Commission Notice on the concept of concentration under Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings, [1998] O.J. C66/5.

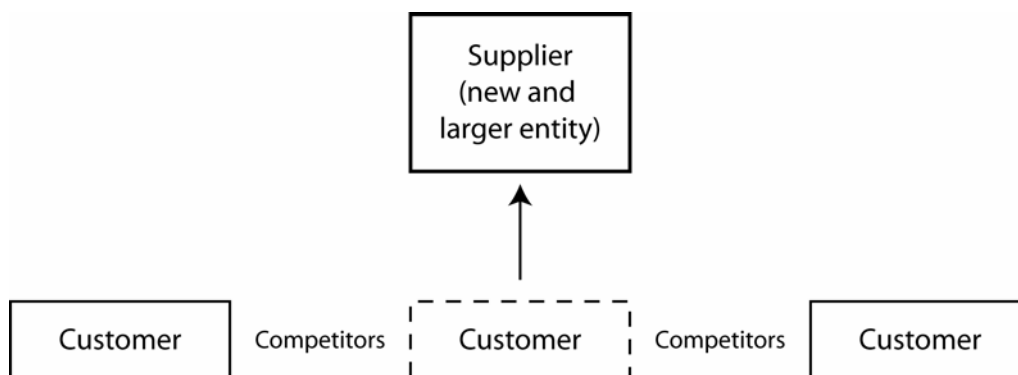
as a consequence of its obtaining market power. A situation where competition is limited in this way and where the merger leads to the situation where the new entity is able to unilaterally increase price and restrain output is said to be a situation of *single firm dominance*.

Other consequences of a horizontal merger where the competition is restrained are that it could lead to a significant impact on the market conditions, where new competitors might have difficulty entering the market, and to a more favourable climate for the remaining competitors to coordinate their price policy and their output. If this is the result of a merger there is said to be a situation of *oligopolistic dominance.*[15]



2.3 Vertical Mergers

A vertical merger takes place when two or more undertakings involved in different stages of production merge. One reason to a vertical merger could be to secure the supply of raw materials or secure the outlet of the products.[16] This could lead to anti-competitive behaviour especially if there is horizontal market power at one or several vertical levels. Consequently, the risk in a vertical merger could be foreclosure or collusive behaviour.[17]



Note: Conglomerate Mergers are the third type of mergers, described in a footnote[18] *below.*

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[15] Bishop, S. and Walker, M., The Economics of EC Competition Law, pages 143 *et seq*.
[16] Jones, A. and Surfin, B., EC Competition Law, page 704.
[17] Bishop, S. and Walker, M., The Economics of EC Competition Law, page 145.
[18] Conglomerate mergers are the last type of merger, but not worth having its own chapter in this thesis, as it is not often seen as a detriment of competition. Conglomerate mergers are between undertakings that are not in competition with one another. Based on this fact conglomerate mergers have often been looked upon as being compatible with the competition rules within the common market and the Merger Regulation. The Commission will however, under the Merger Regulation, investigate to find out if these types of mergers will create or increase market power. Bishop, S. and Walker, M., The Economics of EC Competition Law, page 145.

2.4 The Notion of Concentration

According to the Merger Regulation a *concentration* arises when two or more previously independent undertakings merge, or one or more persons already controlling at least one undertaking or one or more undertakings acquire direct or indirect control of the whole or parts of one or more undertakings. Recital 23 of the Merger Regulation further states that a concentration "…brings about a lasting change in the structure of the undertakings concerned".

Consequently the Merger Regulation will apply if a concentration will arise either by way of a merger or by way of a change of control.[19]

Neither the Merger Regulation nor the Commission Notice on the concept of concentration has a definition of a *merger*. One common interpretation is that a merger occurs when all the rights and liabilities of one or more firms are transferred to another firm.[20] According to the Notice a concentration is when two or more independent undertakings amalgamate into another undertaking and therefore cease to exist as different legal entities or when one undertaking absorbs another so that one of them retains its legal identity and the other ceases to exist as a separate legal entity. This is also the case when the combining of the activities of former independent undertakings leads to the creation of a new and single economic unit, i.e. if two or more undertakings retain their legal structure and agree on the creation of a common economic unit.[21]

2.5 The Power of the Commission

Article 2(1)[22] of the Merger Regulation obliges the Commission to assess whether a notified[23] concentration is compatible with the common market or

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[19] Cook, C.J. and Kerse, C.S., E.C. Merger Control, page 24.

[20] Cook, C.J. and Kerse, C.S, E.C. Merger Control, page 27.

[21] Commission Notice on the concept of concentration under Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings, [1998] O.J. C66/5, paras 6 – 7.

[22] Article 2(1): "Concentrations within the scope of this Regulation shall be appraised in accordance with the following provisions with a view to establishing whether or not they are compatible with the common market. In making this appraisal, the Commission shall take into account:

(a) the need to preserve and develop effective competition within the common market in view of, among other things, the structure of all the markets concerned and the actual or potential competition from undertakings located either within or without the Community;
(b) the market position of the undertakings concerned and their economic and financial power, the alternatives 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 or services, of interest 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."

[23] The Merger Regulation and its Amendment (Council Regulation 1310/97 [1997] O.J. L180.) states that a merger has to be notified to the Commission if it has a *community dimension*, i.e. if it meets certain thresholds:

not and Article 2(2)[24] and 2(3)[25] define when this will or will not be compatible with the common market. The Commission needs to investigate whether a concentration will lead to the acquisition or strengthening of a dominant position that will result in a significant impediment on competition or not. If the answer is yes, the concentration will be prohibited.

The Merger Regulation focuses on the *creation* or the *strengthening* of market power and not on the abuse of an already existing position of market power. Articles 81 and 82 of the EEC Treaty deal specifically with such abuse. There are no exemptions under the Merger Regulation and the analysis made under the Merger Regulation is prospective while the analysis made under Articles 81 and 82 EEC are retrospective.[26] The key words under the Merger Regulation are the *creation* or the *strengthening* of a *dominant position*.

2.6 Dominance

The Merger Regulation takes clear action against concentrations that have community dimension and which creates or strengthens a dominant position on the relevant market involved. This is shown in Article 2(3) that states that 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. This Article authorises the Commission to prohibit a notified merger.

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the combined aggregate worldwide turnover of all the undertakings concerned is more than ECU 5 000 million; and the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 250 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.Further, a merger could meet the community dimension where: (a) the combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 2 500 million; (b) in each of at least three Member States, the combined aggregate turnover of all the undertakings concerned is more than EUR 100 million;
(c) in each of at least three Member States included for the purpose of point (b), the aggregate turnover of each of at least two of the undertakings concerned is more than EUR 25 million; and (d) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 100 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

[24] Article 2(2): "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."

[25] Article 2(3): "A concentration which does 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 incompatible with the common market."

[26] Jones, A. and Surfin, B., EC Competition Law, page 751.

2.7 Form CO[27]

For the purpose of defining the relevant market and assessing market power, the Commission needs extensive information from the undertakings concerned in the merger but also from other undertakings and parties involved on the proposed relevant market. The process of getting information starts with the undertakings filling out a questionnaire; Form CO.

When notifying the Commission of a concentration that falls under the Merger Regulation, the parties are obliged to fill out Form CO. The undertakings are obliged to provide the Commission with exhaustive statement of facts, circumstances and potential consequences and what effects the concentration will have on the relevant market. The Commission is aware that the obligations imposed on the undertakings are relatively high and that the undertakings concerned not always are the owners of all information requested by the Commission. In order to facilitate the burden of the undertakings and the risk of the notification being incomplete the Commission provides an opportunity to discuss the intended concentration formally and in strict confidence before the notification is being filed.[28] When the Commission has received a notification of a merger it has a limited amount of time for making an examination and coming to a decision. According to Article 10(1) of the Merger Regulation and Article 4(2) and (4) of the Implementing Regulation[29] the Commission shall examine the notification as soon as it is received and inform the undertakings concerned its decision without delay. As Form CO needs to be filled out correctly the time-limits set out in the Merger Regulation will not begin to run until all information needed has been supplied by the undertakings concerned.

Section 6 of Form CO requires the notifying parties to define the relevant product and geographic markets, and to identify which of those relevant markets are likely to be affected by the notified operation. The definition of affected market or affected markets can refer to a relevant market(s) made up either of products or of services. By evaluating and determining the relevant product market and the relevant geographical market the undertakings concerned and the Commission respectively assess the market power of the new entity.

2.7.1 Relevant Product Market

Under Form CO, Section 6, a relevant product market comprises of all those products and/or services which are regarded as interchangeable or substitutable

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[27] Form CO Relating to the Notification of a Concentration Pursuant to Regulation (EEC) No 4064/89.
[28] Form CO Relating to the Notification of a Concentration Pursuant to Regulation (EEC) No 4064/89, recital 10.
[29] Commission Regulation (EC) No 447/98 on the notifications, time limits and hearings provided for in Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings ”Implementing Regulation”, [1998] O.J. L61/1.

by the consumer, by reason of the products' characteristics, their prices and their intended use. A relevant product market may in some cases be composed of a number of individual products and/or services which present largely identical physical or technical characteristics and are interchangeable.

The presumption made with regard to a relevant product market is that "…the relevant market is the narrowest which can be identified, *i.e.* that used by an undertaking for its own marketing purposes."[30] Other important factors with regard to the definition of the relevant product market are for example the analysis of why the products or services in these markets are included and why others are excluded. The undertakings could for example provide the Commission with calculations for substitutability, conditions of competition, prices, cross-price elasticity of demand or other factors relevant for the definition of the product markets.

2.7.2 Relevant Geographic Markets

Section 6 of Form CO further states that the relevant geographic market comprises of the area in which the undertakings concerned are involved in the supply and demand of relevant products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring geographic areas because, in particular, conditions of competition are appreciably different in those areas.

Important factors with regard to the definition of the relevant geographic market are for example nature and characteristics of the products or services concerned, the existence of entry barriers, consumer preferences, appreciable differences in the undertakings' market shares between neighbouring geographic areas or substantial price differences.

2.7.3 Affected Markets

The undertakings also have to provide the Commission with information regarding markets likely to be effected by the concentration. The Form CO gives a definition of such *affected markets* as being relevant product markets where, in the EEA territory, in the Community, in the territory of the EFTA States, in any Member State or in any EFTA State, two or more of the parties to the concentration are engaged in business activities in the same product market and where the concentration will lead to a combined market share of 15% or more. These are horizontal relationships, or where one or more of the parties to the concentration are engaged in business activities in a product market, which is upstream or downstream of a product market in which any other party to the concentration is engaged, and any of their individual or combined market shares is 25% or more, regardless of whether there is or is not any existing supplier/customer relationship between the parties to the concentration. These are vertical relationships.

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[30] Cook, C.J. and Kerse, C.S., E.C. Merger Control, page 135.

If any of these criteria are met, the undertakings involved have to provide the Commission with data on the markets within the EEA, the Community, the territory of the EFTA States and any Member State. They also have to describe the relevant product and the geographic markets for the product and markets that are closely related to the affected market. Even if there are no affected markets in the meaning of the definition, the undertakings still have to identify and describe the product and the geographic scope of the markets where the notified concentration would have an impact.

2.7.4 Comments

Form CO is an important tool for the Commission to get information on the market conditions where the merging undertakings are operating. The merging parties are the first ones to give information to the Commission the information given in Form CO and it is not unrealistic to assume that the information given is subjective. Even so, this way of getting information is probably the quickest way to get the process started. The merging undertakings are always interested in a fast evaluation of the merger since time is money.

It is not an easy task for the Commission to evaluate the subjective information and sometime the Commission asks third parties affected by the merger on their view of the relevant market and the distribution of market power in the market. This information could also be subjective. A way to get information more close to the factual circumstances on the market, more “realistic” information, might be to ask for information based on neutrally valued facts only that would then be put into an econometric model in order to get an objective assessment of the relevant market. Based on this evaluation and the initial determination of the relevant market the Commission would then better assess whether the proposed merger will have a negative impact on competition in the Common Market.

3 Market Power

In competition law it is sometimes said that if you win the market, you win the case. Merging undertakings have much to gain by appearing to hold minimal market power. It is in their interest to define broad product markets and wide geographic markets and to emphasise factors like demand-side substitutability, where customers switch to competing brands.

The Commission is often criticised by merging parties for lack of transparency in the process of defining markets and measuring market power. Among other things, this has lead to the publication of a Notice on the definition of the relevant market[31]. Lately, several Commission Decisions have been overturned on appeal to the CFI.[32] It has become evident that the Notice is not enough guidance when investigating market power.

In this chapter we have collected theories and practical tools that can be used when determining whether a merger should be allowed or not. The aim of all these theories and tools are to give guidance when deciding if a proposed merger will lead to abusive and counter-competitive behaviour on the market.

Below, we look at the two parts that make up market power; *market* and *power* respectively. Only when a relevant market has been defined can market power be correctly estimated.

3.1 Market

In competition law the definition of the relevant market often is critical to the correct outcome in a given case, be that a case under Articles 81 or 82 EEC or a proposed merger between two undertakings.

While the general concept of considering competition on a relevant product market and a relevant geographic market is non-controversial[33], the practical application of this constantly raises questions because there are so many different ways to measure the market.

The text below starts with a brief presentation of the role of market definition. The notion of competition is then discussed and the concept of competitive constraints is introduced.

After this follows a description of the economic theories used when defining the relevant market. In a separate section, theories affecting only the geographic market are covered.

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[31] Commission Notice on the definition of the relevant market for the purposes of Community competition law, OJ C 372 on 9/12/1997

[32] Described in more detail in the next chapter

[33] It has been laid down in numerous decisions by the European Court of Justice and the Court of First Instance, e.g. in case 6/72 Continental Can, ECR 1973 p. 215

3.1.1 The Role of Market Definition

In a merger case, the Commission has to assess the future effects on competition of the merger. The question to be answered is: will the merged firm have enough market power to act independently of its competitors by e.g. profitably raising prices?[34]

In December 1997, the Commission published its Notice on the definition of the relevant market for the purpose of clarifying Community competition law. The purpose of market definition *per se* is stated in the Notice:

"Market definition is a tool to identify and define the boundaries of competition between firms. It allows to establish a framework within which competition policy is applied by the Commission. The main purpose of market definitions is to identify in a systematic way the competitive constraints that the undertakings involved face. The objective of defining a market in both its product and geographical dimension is to identify those actual competitors of the undertakings involved that are capable of constraining their behaviour and of preventing them from behaving independently of an effective competitive pressure. It is from this perspective, that the market definition makes it possible, *inter alia*, to calculate market shares that would convey meaningful information regarding market power for the purposes of assessing dominance or for the purposes of applying Article [81]."[35]

The Commission focuses heavily on market shares as a proxy to market power. The reason for defining markets is to establish whether the merged undertaking will dominate the market and act independently from its competitors. As will be shown below, while there are other ways of estimating market power than market shares the objective – assessing market power – is the same.

3.1.2 Notion of Competition[36]

There is no established definition of competition. Instead, economists use three different models of competition to describe the outcome of different market scenarios. These scenarios can be divided into

- perfect competition,
- monopoly/monopsony, and
- oligopolistic markets.

Comparing a real-world market before and after a proposed merger with the different models of competition can give important information. If the market post merger is closer to perfect competition than to monopoly or oligopoly,

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[34] When notifying the Commission of a concentration that falls under the Merger Regulation, the parties are obliged to use a standard form: Form CO. Where applicable the sections relating to the market definition are described above.
[35] Para 2.
[36] This section is based on Hovenkamp, Economics and Federal Antitrust Law, chapter 1.

chances are the merger could be allowed without damage to competition. Conversely, should the market post merger resemble an oligopolistic or even monopolistic market, the merger can be assumed to have an adverse effect on competition.

3.1.2.1 Perfect Competition

The notion of perfect competition assumes that

1) all sellers make an absolutely homogenous product, so that customers are indifferent as to which seller they purchase from, provided the price is the same;
2) each seller in the market is so small compared to the market as a whole that the seller's increase or decrease in output, or even its exit from the market, will not affect the decisions of other sellers in the market;
3) all resources are completely mobile, or alternatively, all sellers have the same access to the needed inputs;
4) all participants in the market have perfect knowledge of price, output and other relevant information about the market.

None of the above conditions are met in a real market. Price discrimination resulting from differentiated products, concentration of firms and barriers to information will always be present.

In a market with perfect competition prices tend towards marginal cost of production where there is no profit (but also no loss). If one firm was to raise prices and make excessive profits it is probable that a new firm would enter the market with lower prices, hoping to earn part of these excessive profits.

This might at first sound odd, since firms are in business to make profit. However, zero profits in economic terms means that all factors used in production including capital receive their opportunity cost and no more. In particular, they earn their cost of capital. Economic profit is defined as revenues minus opportunity cost.

3.1.2.2 Monopoly / Monopsony

In a monopoly, the only firm selling a product has the possibility of maximising profit by optimising the number of units produced[37] in relation to price. This is not in the best interest of consumers.

Economists recognise monopoly as ineffective because the monopolist can sustain a difference between marginal cost of production and market price that would not be possible in a competitive market.

A *de facto* monopolist, not legally protected, must continually deter competitors from entering the market. Large profits in a market attract new

[37] Normally this means that fewer units are produced compared to a competitive market.

entry. This also means that the monopolist is willing to spend more to exclude competitors from the market.

In a monopsony, a single buyer can control the market by forcing suppliers to sell at lower prices than would prevail in a competitive market. Because of this inefficiency, suppliers may be forced to reduce output below the competitive level in order to reduce average cost of production.

3.1.2.3 Oligopolistic Markets

An oligopoly is a market dominated by a few large suppliers, selling similar products. Undertakings operating in an oligopoly produce branded products, because marketing and advertising are important competitive tools when products are similar. Because of the limited number of players in the market, there is interdependence in price and output between undertakings.

This mutual recognition of other players is not identified in the model of perfect competition, where each firm is too small to make an impact on the market, or monopoly, where there are no competitors to worry about. To investigate competition in markets with only a limited number of players, economists have produced theories about oligopolistic markets based on game theory.

Two models of oligopoly relevant to competition law exist; the Cournot model and the Bertrand model.[38]

The Cournot model of oligopoly assumes that, in a market with only two firms, each firm competes by maximising profit by adjusting output, taking into account the output of the other firm.[39] It follows from the model that even with more than two competitors prices are higher than marginal cost.

The Bertrand model of oligopoly assumes that firms adjust prices, not output, to compete with each other. The two firms in the market set their prices taking into account the price of the other firm. The theoretical result of the Bertrand model is the same as the Cournot model, prices higher than marginal cost.

This model also introduces two problems; it does not consider capacity constraints, and it assumes that products are homogenous.

Both models assume that there is some degree of competition in the market. The case where oligopoly firms collaborate to charge the monopoly price and get monopoly profits is not identified in either model.

In an oligopoly, the primary concern with a merger is that the merging firms stop being competitors.[40] This could lead to price raises, because sales that would otherwise have been lost to a competitor because of the higher prices are kept within the merged firm's product portfolio.

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[38] Bishop, S. and Walker, M., The Economics of EC Competition Law, pages 22 – 24.
[39] There are also other assumptions; e.g. each firm is allowed to determine its output only once.
[40] Vickers, J., *Competition Economics and Policy*, page 99.

Examples of markets with oligopolistic characteristics are the markets for petrol retailers or mortgage lenders. A small number of competitors act on a market with largely transparent pricing structures. Undertakings with small market shares may simply follow changes in price decided by the major players.

From the customer's point of view, oligopoly can be expected to lead to higher prices. This means that the Commission will aim at declaring invalid any merger that leads to the establishment of an oligopoly.

3.1.3 Theories About the Relevant Market

A simple definition of a relevant market is "a market worth monopolising"[41]. In economic terms this means that an undertaking A would be inclined to supply products or services to this market in an effort to eliminate competition and thereafter maximise profits by raising prices independently of competitors; because A is dominant on the relevant market, consumers have no acceptable substitutes for the products only A offers.

There are many reasons why a product or service might *not* be worth monopolising. Most notable is the perceived threat of competitors or consumers acting in a manner that makes the aspiring monopolist's actions unprofitable.

The Commission lists the following main reasons why monopolisation might not be profitable in its Notice on market definition, covered in the following sections:[42]

- demand-side substitution,
- supply-side substitution, and
- potential competition.

When determining the relevant market, it is important to always look for the narrowest range of products and the smallest geographic area where a potential monopolist could sustain a price increase. If a broader product range or a wider geographic area than is necessary is selected, there is risk of a false negative result indicating that the merging undertakings are insignificant players on the market and allowing mergers that impede competition.

Vickers points out that it is important to avoid the "zero-one" fallacy when investigating the relevant market. By this he means that it is could lead to false positive or negative results to consider products within "the market" as extremely substitutable, and products outside "the market" as irrelevant.[43] Outside products always affect the market. The important thing is to establish

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[41] Bishop, S. and Walker, M., The Economics of EC Competition Law, pages 48 *et seq*.
[42] Commission Notice on the definition of the relevant market for the purpose of Community competition law, [1997] O.J. C372/5, para 13.
[43] Vickers, J., *Competition Economics and Policy*, page 100.

which products or geographic areas constitute a sufficient competitive constraint on the merging undertaking to be included in the relevant market.

3.1.3.1 Demand-side Substitution

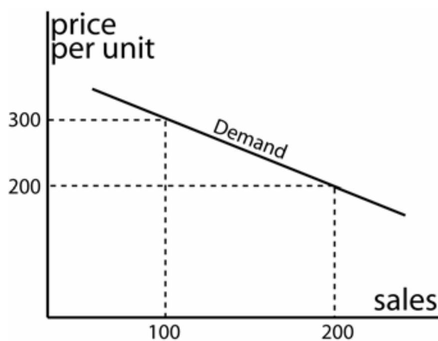
When consumers change to a viable substitute product or begin sourcing their required products in another geographic area, demand-side substitution takes place.

Elasticity of demand is a short-hand expression for the relationship between a particular change in the price of a product and the corresponding change in demand for it. In competition law, two flavours of elasticity of demand are used as tools aiding market definition:

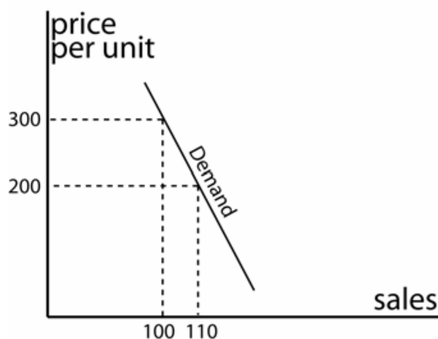
- *own-price elasticity* of demand, meaning the change in demand following a price change not considering other products in the market;
- *cross-price elasticity* of demand, meaning the change in demand of product B following a price change in product A.

When the elasticity of demand in a market is greater than one, the market is termed elastic. When elasticity of demand is below one, we call the market inelastic.

Own-price elasticity is illustrated in the following graphs. The first shows a relatively elastic demand curve and the second a relatively inelastic demand curve.



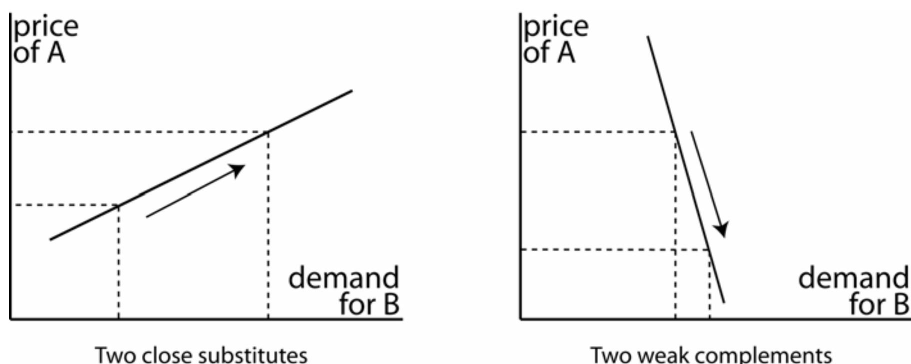
Sales rise from 100 to 200 following
a price change from 300 to 200
% change in price = 50 %
% change in demand = 100%
Own-price elasticity 100/50 = 2
i.e. demand is price elastic



Sales rise from 100 to 110 following
a price fall from 300 to 200
% change in price = 50 %
% change in demand = 10%
Own-price elasticity 10/50 = 0.2
i.e. demand is price inelastic

Cross-price elasticity is especially useful in competition law, because it calculates the percentage of lost sales (to competing products) following a price rise of X per cent. An increase in price of 15 per cent leading to a 10 per cent reduction in sales yields an elasticity of demand of 15 per cent / 10 per

cent or 1.5. As will be shown later, knowing price elasticities between products can be useful when performing a hypothetical SSNIP test.[44]



Two close substitutes

Two weak complements

Although unusual, it is worth mentioning that barriers to demand-side substitution should be considered. If consumers are lagged significantly when switching to other sellers following a price increase this could in effect mean that the firm raising prices has more market power than a low elasticity of demand would suggest.

If there is no relationship between two products, the cross price elasticity of demand is zero.

3.1.3.2 Supply-side Substitution

When enterprises not currently offering viable product alternatives are able to easily relocate production capacity to products competing with the prospective monopolist this is said to be a sign of supply-side substitution.

It is also important to investigate the amount of time it takes for supply to increase following a price increase. A dominant firm may be able to earn monopoly profits in the time it takes for new competitors to enter the market. Another factor to take into consideration is the possible excess supply capacity of a dominant firm. Knowledge of such capacity may deter prospective competitors from entering the market because the monopolist would then increase output and lower prices in an attempt to drive competition away.[45]

In practice, this means that products or services on the relevant market must have unique characteristics of production, which makes entry by competitors from neighbouring markets inefficient.

Elasticity of supply is the relationship between changes in the price of a product and the amount produced.[46] If prices increase, elasticity of supply measures how large the following increase in production is. Knowing the elasticity of supply can help predict the behaviour of competitors in a market.

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[44] Below, chapter 3.1.4.1.
[45] Hovenkamp, H., Economics and Federal Antitrust Law, page 7.
[46] *Ibid.,* page 7.

If supply is elastic, producers increase production without time delay or cost increase. When supply is inelastic, firms take longer to adjust production levels.

3.1.3.3 Potential Competition

Potential competition can also be seen as a competitive constraint, meaning that the likelihood of competitive behaviour on the market following new entry has to be evaluated.

It is recognised in economic theory that supracompetitive prices attract new sellers into the market. This theory is often used when arguing that a market will stay competitive although the number of market players is reduced by a merger between competitors.

Entry barriers, regulatory impediments and significant entry lag because of need for research, production and delivery are all factors to take into account when assessing the threat of potential competition.

3.1.4 Techniques Used for Market Definition

The following techniques are used when defining both the relevant product market and the relevant geographic market.

3.1.4.1 SSNIP Test

In the 1997 Notice on the definition on relevant market, the following guidelines for market definition can be found (paragraph 17):

"The question to be answered is whether the parties' customers would switch to readily available substitutes or to suppliers located elsewhere in response to a hypothetical small (in the range 5 % to 10 %) but permanent relative price increase in the products and areas being considered. If substitution were enough to make the price increase unprofitable because of the resulting loss of sales, additional substitutes and areas are included in the relevant market. This would be done until the set of products and geographical areas is such that small, permanent increases in relative prices would be profitable."

This hypothetical test examines the effects of a small but significant non-transitory increase in prices ("SSNIP test", "5% test" or "hypothetical monopolist test"). In effect, this is a test for demand-side substitutability. If enough marginal consumers switch to a competing product or to a competing geographical area following the price increase to make the increase unprofitable, the conclusion is that the competing product or geographic area is in the same market as the product or area under investigation. This can also be termed cross-price elasticity of demand.

In practical terms, it may sometimes be hard to come by the data to support a SSNIP test. In these cases the Commission commonly surveys consumers to gauge their reactions to a hypothetical price increase in the product under

investigation. It has been opined[47] that these surveys are unscientific and no proper substitute for other econometric measurements or careful examination of the product's uses, functionality and physical characteristics.

3.1.4.2 Price Correlation Analysis

Price correlation analysis is made based on the assumption that prices for products on the same market should move together over time. This type of test has two strong advantages over other tests. First, the underlying principles of the test are easy to understand.

Secondly, the analysis can be done relatively fast and it is relatively easy to carry out. Because of these factors, price correlation analysis has become a standard tool in the evaluation of mergers within the EU, both by the Commission and by merging parties.[48]

High correlation of (quality-adjusted) prices suggests products are in the same market. Low correlation means it is likely that the products investigated are not in the same market.

Despite these advantages, some criticism of price correlation exists. A number of weaknesses are pointed out by Wills[49] and Bishop/Walker[50]. In practice, there can be significant lag between movements in prices, leading to a false negative result. In addition, a common influence or common cost can give a false positive result suggesting counter-competitive behaviour where none exists.[51] Ignoring the inherent weaknesses of price correlation studies can result in a narrow market when the true market is wide and a wide market where the true market is narrow.[52]

Another problem with price correlation analysis may be determining when correlation is "high enough".[53]

Wills suggests the solution to this is the use of "stationarity" or "unit root" test, as described below. Bishop/Walker encourages use of price correlation analysis despite its shortcomings, because it is such a simple and powerful tool.

3.1.4.3 Stationarity Test

Based on the hypothesis that prices of products on the same market will move together over time, a stationarity test (or "unit root" test) can be carried out. Typically, this calls for several years of data on prices of the products tested.

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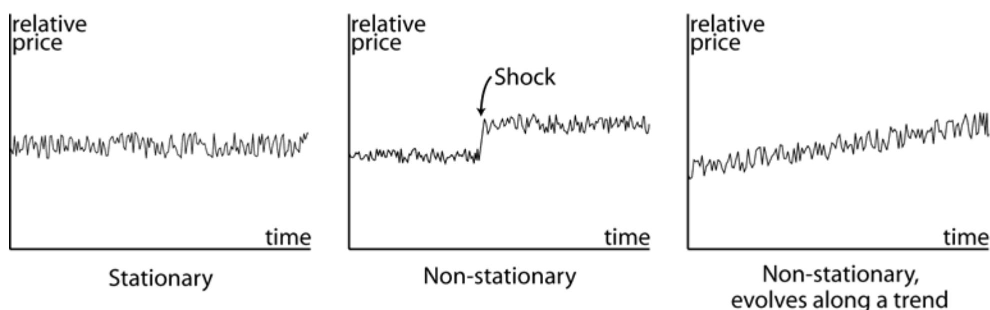
[47] Cook, C.J. and Kerse, C.S., E.C. Merger Control, page 136.
[48] Bishop, S. and Walker, M., The Economics of EC Competition Law, page 168 and page 225.
[49] Wills, H., *Market Definition: How Stationarity Tests Can Improve Accuracy*, page 5.
[50] Bishop, S. and Walker, M., The Economics of EC Competition Law, page 225.
[51] For example, prices of products deriving from oil may be strongly correlated although in different markets.
[52] Bishop, S. and Walker, M., The Economics of EC Competition Law, page 226.
[53] Wills, H., *Market Definition: How Stationarity Tests Can Improve Accuracy*, page 5.



When the relationship between data series is shown to return to a constant long-run value, the time series is said to be stationary. A time series is non-stationary if the effects of shocks are permanent, or if the time series evolves along a trend. A stationary time series indicates that products are in the same market and a non-stationary time series suggests products are in different markets.

In this way, it is possible to test for statistically significant deviations from a constant level of relative prices. When test data is collected over several years, false positives are less likely because common influences on prices cancel out each other over time. Another advantage over ordinary price correlation is that the result is much less sensitive to significantly lagged responses.

The disadvantages of using stationarity tests are common to those in price correlation analysis.[54]

3.1.4.4 Shock Analysis

The hypothesis behind shock analysis is similar to that of stationarity tests. If, following a shock in the market, prices of product A and product B move together, this would suggest that products A and B are in the same market.[55] Using past events in the marketplace, predictions of competition in the current market can be made.

Examples of shock to the market, where it could be informative to study market conditions before and after the shock, are introduction of new products, demand and supply shock, tax rate shock, natural disasters, currency exchange rate shock or a change in the number of competitors or change in ownership of these undertakings.

To perform a shock analysis, several years of data on prices and the behaviour of market actors must be collected to avoid false positives and false negatives.

Shock analysis can be especially helpful when arguing that two products are not substitutable. Should price levels of the two products develop differently

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[54] Wills: As with all statistics, if the data is uninformative the statistical result will give a misleading result. Also, if prices are influenced by transport costs, taxation or quality this can influence the test. If these factors are known and we have a measure of them, they can be controlled within the model. Some of these factors have to be estimated by parties to a merger under section 7.5 in form CO.

[55] Bishop, S. and Walker, M., The Economics of EC Competition Law, pages 173 *et seq*.

following the common shock, this suggests the products are not in the same market.

3.1.4.5 Granger Causality

The somewhat complex concept of Granger causality[56] is used in econometrics to investigate the degree to which variables are interdependent.

A variable X is said to Granger-cause variable Y if taking into account past values of variable X leads to improvement in the prediction of variable Y.

When applied to market definition, the hypothesis is that prices of products in the same market are interdependent. The price of product A will depend on the price of product B, and vice versa. If Granger-causality exists between prices, the price of A can be better estimated by knowing past prices of both A and B than knowing only past prices of B. This test has to be done on a long time series with data on prices of both products.

There are many risks with using Granger causality alone to define markets. First, hidden or unknown variables may be the cause of a positive result, i.e. indicating products are in the same market. Because real-world products are not necessarily homogenous, factors such as quality or design have to be taken into account in the investigation. Secondly, high quality input data is key to a usable result.

The primary problem with Granger causality used in competition law is that while results can be statistically significant, they are not necessarily economically relevant. While the price of product A can be shown to influence the price of product B to a specific degree of certainty (like 95%) it is not automatically true that product A poses a significant competitive constraint on product B.

The main use for test for Granger causality is in conjunction with other tests when defining the relevant market.

3.1.5 Techniques Used Only When Defining the Relevant Geographic Market

The following techniques are used only for defining the relevant geographic market.

3.1.5.1 Shipment Studies and Trade Pattern Analysis

When defining the relevant geographical market, shipments (i.e. sales) of goods from other regions can be performed. If the quantity of sales originating outside the area in question is relatively large, this indicates that the studied market faces significant competition from foreign suppliers.

[56] Introduced by C. W. J. Granger in 1969.

The advantage of studying shipments is that it requires only quantity data. In some cases, this can be the only available reliable data. This might be the case when the only pricing information is list prices that are known to be deviated from randomly.

The impact of imports in a market can be seen as the ratio between produced goods (less export) and consumption.[57]

It is important to note that although large trade flow implies wide markets, the opposite is not always true. There can be several reasons for limited trade flow between regions, one being high costs of transportation in relation to the economic value of the product, another being tariffs and quotas putting restrictions on trade.[58] If, however, transport costs and other barriers to trade are absent and intra-region trade is still relatively sparse the geographic areas could be interpreted as both being two separate geographic markets *and* as constituting a competitive constraint on each other. In this case, with no barriers to entry, prices could perhaps not be raised in any region without the direct impact of fierce competition from the outside.[59] It is therefore hazardous to rely on a trade pattern analysis showing limited trade without investigating the true reason for this.

The main advantage of shipment tests is that they are fairly intuitive and results are therefore persuasive. Secondly, information on trade flow can be obtained from a number of sources and the data required is only quantitative.[60]

Disadvantages with shipment tests include them being indirect proxies of competition on the market and, as indicated above, act persuasively only when arguing a wide market due to large quantities of shipments. The absence of shipments does not say much about the level of competition in the market. Further, hidden factors affecting competition, such as geographic price discrimination could lead to false negative results.[61]

The extent to which the Commission accepts the argument of markets within the Community being affected by trade with for example the US and Asia is unclear.

3.1.5.2 Transport Cost Studies[62]

Evaluating costs of transportation between geographic regions can give information on competitive restraints between regions. The main question to be

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[57] This is the ”LIFO” or ”Little in From Outside” part of the Elzinga-Hogarty test used in the U.S. anti-trust law. It is explained in some detail by Bishop/Walker on pages 251 *et seq*. According to Bishop/Walker the test has only rarely been referred to explicitly in Commission decisions. Cook/Kerse claim the test has been rejected by the Commission inter alia because it does not consider mutual interpenetration between territories concerned (page 141).
A high LIFO indicates that demand in a given region is primarily served by local production, in turn indicating that the region is a separate geographical market.
[58] Bishop, S. and Walker, M., The Economics of EC Competition Law, page 260.
[59] *Ibid.*, page 260.
[60] *Ibid.*, page 263.
[61] *Ibid.,* page 264.
[62] Bishop, S. and Walker, M., The Economics of EC Competition Law, pages 262 *et seq*.

asked is whether it would be profitable to import goods into the market following a local increase in prices of 5 – 10 per cent (compare: SSNIP test).

Used in conjunction with shipment studies, it can be determined how much further it would be profitable to ship products following a price increase on the market. It can be especially useful when there is little trade flow at current prices as it suggests if cost of transportation prohibits effective competition between regions or if supply-side competition could take place if prices were raised in one region.

If an analysis of transportation costs shows that imports from area A into area B are affected by significant transportation costs, this is of course a direct indication of limited supply-side competition from area A.

3.2 Power

The aim of investigations under EC competition law is to establish whether a firm has and exercises market power.[63] For mergers, the main interest is the creation or strengthening of a dominant position.

Once a relevant product and geographic market has been defined, the market power of merging undertakings and competitors must be estimated. In this section we detail the largely practical and empirical tests used as an aid when deciding whether or not a proposed merger should be allowed.

The deceptively simple concept of market power offers both authorities and parties much headache. Parties to a merger often have much to gain by not appearing to have significant market power. For the Commission, evidence of market power put forward by the parties must always be interpreted with this in mind.

In practice, a number of techniques for estimating market power have made their way into competition law, directly or indirectly.

Lately – perhaps spurred by the increased burden of proof introduced by the CFI – a number of articles and books have presented techniques that supplement the more traditional tools.

We have collected these techniques in the following sections.

3.2.1 Market Share

A common misconception is that market share is the same as market power. This is not necessarily true.

In fact, the Commission has allowed a number of mergers despite post-merger market shares of more than 50 per cent. High market shares in a narrow market, does therefore not equate to real market power.[64] Nevertheless, market

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[63] Bishop, S. and Walker, M., The Economics of EC Competition Law, page 12.
[64] Neven, D. *et al*, Merger in daylight, page 104.

share is a proxy to market power and has traditionally been used frequently in competition law, perhaps because of the tempting (but overly simplistic) possibility of assigning market power a numerical value.

Competitive constraints in a market can lead to competitive behaviour despite high market shares. For example, the risk of entry into the market by a competitor can be enough to keep prices competitive. Buyer power, or demand side substitutability, was accepted in the Schneider / LeGrand case as a reason for allowing a merger despite high market shares.[65]

3.2.2 Marginal Cost

Market power can be viewed as the ability of an undertaking to deviate profitably from marginal cost pricing.

In a situation of perfect competition[66], firms selling homogenous products cannot affect market prices. As soon as firm A raises prices, competitors will enter the market and sell the products at marginal cost. In the model of perfect competition, this leads to firm A losing all customers.

As soon as a firm can raise prices above marginal cost without losing all customers, it can be said to possess market power.[67] Because all real markets deviate from the model of perfect competition, it is interesting to investigate the extent to which a firm can wield market power by raising its prices above marginal cost.[68]

Pricing at or even below marginal cost cannot simply be interpreted as the result of a highly competitive market. A firm might lower prices in an attempt at predation, thereby capturing market shares from competitors. In this case, the ability to take predatory action also signifies that the firm has market power.[69]

Another interesting observation is that prices at or only slightly above marginal cost might result from an inflation of costs in a market with little competition. With more competition in the market, a monopolist could lower costs to match prices offered by entering competitors.

In a merger case, the merging parties may present data showing that prices do not deviate significantly from marginal cost thereby arguing that the merger should be allowed.

3.2.3 Price Concentration Analysis

By comparing prices in different regions where concentration among enterprises varies, a measure of the relationship between prices and

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[65] See chapter 4.2.3.2 below
[66] See chapter 3.1.2.1 above.
[67] Neven, D. *et al*, Merger in daylight, page 17.
[68] Hovenkamp, H., Economics and Federal Antitrust Law, page 57.
[69] Neven, D. *et al*, Merger in daylight, page 17.

concentration can be achieved. If the test shows that prices are low regardless of high levels of concentration, this suggests that further concentration, in the form of a merger, need not be a concern.

The reasoning behind price concentration analysis is intuitive. If high concentration of firm A in a market leads to higher prices, it can be argued that high concentration equals high market power. However, before conclusions can be drawn from the results, a number of other factors affecting prices that must be taken into account. High prices in areas with high concentration could result from something as simple as these areas being remote locations with higher transportation costs and fewer competitors because of a relatively small customer base (i.e. still a high concentration in the smaller market).[70]

Often, the use of the Herfindahl-Hirschman Index (HHI) is suggested. The HHI is the sum of the squares of the market shares of *all* firms operating in the region after a proposed merger. A typical market with an HHI of 1800 could have one firm with a market share of 30%, one with 20%, and five firms with a market share of 10% each ($30^2+20^2+10^2+10^2+10^2+10^2+10^2 =1800$). A market with four 20% firms and two 10% firms also has an HHI of 1800. If the market had only two companies, one at 70% and one at 30%, the HHI would be 5800. The HHI will be introduced in EC merger review in the near future. The Commission has stated that cases with aggregate post-merger HHI lower than 1000 are unlikely to be investigated.[71]

An attractive feature of price concentration analysis is that it addresses the pertinent question of consumer interest directly. If it is established that high concentration in a market leads to dominance and higher prices, it is likely that further concentration through a merger will not benefit consumers. Other tests, such as price correlation analysis and shipment studies, only answer the intermediary question of market definition.

There are some problems with price concentration studies[72], notably

- the question of how to measure concentration,
- the risk of different marginal cost in different regions leading to misguiding results, and
- the important issue of using a heterogeneous product in the study.

According to Bishop/Walker price concentration does not appear to have been relied on in any Commission decisions.[73]

Perhaps the main advantage of price concentration studies is when the result shows absence of concentration. This means that many smaller firms compete in the market, making price co-ordination harder.[74]

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[70] *Ibid.*, pages 267 *et seq.*
[71] Draft Commission Notice of 11 December 2002 (O.J, C331/18). The HHI has been used in US merger review since 1982.
[72] Bishop, S. and Walker, M., The Economics of EC Competition Law, pages 271 *et seq.*
[73] Bishop, S. and Walker, M., The Economics of EC Competition Law, page 270.

3.2.4 Bidding Studies

In markets characterised by bidding for a relatively small number of valuable contracts, competition is limited by the very design of the market. Use of the standard empirical tests can lead to inappropriate results.

In an ordinary market, setting prices over the competitive level will not lead to zero sales. Some consumers will still be willing to pay a premium price as long as the price level is not far too high.

Bidding markets, on the contrary, have a high degree of price discrimination with each consumer being offered a different price.[75] It is said that competition takes place *for* the market, instead of *in* the market.

In some bidding markets, smaller firms can impose a significant competitive constraint on larger firms. The evaluation of market shares in bidding markets may therefore lead to misguiding results. The Boeing/McDonnel Douglas case is a good example of this. Although Boeing would only increase its market share by 6 per cent, it was ruled that the proposed merger would adversely affect competition. One reason behind this was that McDonnel Douglas had a noticeable effect on price levels in bids with Boeing and other competitors.[76]

Studying past tenders and analysing the positions taken by the parties concerned with the merger can yield some important information. If the buyers would have to pay a higher price after the merger because of the assumed reduction in effective competition, the merger should not be allowed.

A problem with analysing tenders is that the fundamental data is sometimes hard to come by because it is held in its complete form only by buyers. Should this happen, Bishop/Walker suggests the more simplistic approach of counting how often firms bid against each other and how many undertakings compete for each tender.[77]

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[74] Neven, D. *et al* (1993), page 32.
[75] Bishop, S. and Walker, M., The Economics of EC Competition Law, page 278.
[76] Commission Decision Case No IV/M.877 – Boeing/McDonnel Douglas.
[77] Bishop, S. and Walker, M., The Economics of EC Competition Law, page 282.

4 Cases

Three Commission Decisions in merger cases, Airtours v European Commission, Schneider Electric v Commission and Tetra Laval BV v Commission have been overturned by the CFI recently. The Commission has been criticised by the CFI for lack of economical reasoning related to market definition and estimation of market power.

4.1 Airtours v Commission, Case T-342/99

4.1.1 Background

On 29 April 1999, the British company Airtours plc, an operator and supplier of package holidays, announced its intention to acquire all the shares in its British competitor First Choice plc, a tour operator in the UK.

On the same day Airtours notified the Commission of the operation and by decision of 22 September 1999, the Commission declared the concentration to be incompatible with the common market and the operation of the European Economic Area pursuant to Article 8(3) of the Merger Regulation. The Commission held that the merger would create a collective dominant position in the UK market for short-haul foreign package holidays, and would significantly impede competition on the common market.[78]

The Court of First Instance annulled the Commission Decision due to numerous errors of assessments and lack of sustainable evidence with regard to the structural features of such an alleged market position.[79] The Airtours decision is remarkable also in the sense of this being the first time in 12 years of EU Merger Regulation that the Commission had been overruled by the CFI in its decision of prohibiting a merger.[80]

4.1.2 The Commission's Analysis

The Commission found that the proposed merger would lead to the impediment of competition on the market and based its assessment on the fact that the merger would result in increased concentration on the relevant market. There would only be three leading tour operators on the market left with a combined market share of approximately 83 - 85 per cent, thus the market power of the remaining three operators would be significant. The competition on the market would also be reduced since First Choice would be eliminated as a supplier/distributor. The interdependence between the remaining operators in

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[78] Commission Decision C (1999), Case No IV/M.1524 – Airtours/First Choice, recital 1.
[79] Haupt, H., *Collective Dominance Under Article 82 E.C. and E.C. Merger Control in the light of* Airtours *Judgement*, page 434.
[80] Loughran, M. *et al*, *Merger Control: Main developments between 1st May 2002 and 31st August 2002*, page 59.

this oligopoly would also significantly increase which would give them an incentive to restrict capacity and raise prices.[81]

4.1.2.1 Definition of the Relevant Market

The Commission came to the conclusion that the market for package holidays consisted of two separate markets, the market for package holidays to short-haul destinations and that for package holidays to long-haul destinations.

In its decision the Commission identified the *relevant product market* as being the market for short-haul foreign package holidays. The reason for this was that the differences between short-haul and long-haul package holidays were more significant than the similarities. The Commission argued that the scope for substitution between long-haul and short-haul flights was limited, that is, the possibility of using the same aircraft for both short-haul and long-haul flights was limited as well as the economical aspects of capital investments. For the ultimate consumer there were also significant differences between short and long-haul package holidays. The Commission addressed the fact that long-haul package holidays seem to appeal to single people or couples without children, people who seemed to travel long distance whenever during the year and short-haul package holidays to families which seemed to travel preferably during the summer season. There was also a difference in transfer time and prices.[82]

Airtours/First Choice challenged the definition of the relevant product market and argued that the relevant product market consisted of *all* foreign package holidays, including long-haul packages.

The Commission found that the *relevant geographic market* was the UK and Ireland respectively. The Commission stated that the European markets for the supply of foreign package holidays were still national in character mainly because producers, marketers and sellers offer their package holidays nationally.[83]

4.1.2.2 Assessment of Market Power

After having defined the relevant market the Commission assessed the market power of the proposed merger and what effect it would have on the relevant market. The Commission found that the "…proposed operation would create a dominant position in the market for short-haul foreign package holidays in the United Kingdom…"[84] thereby affecting competition negatively. The Commission found that the concentration would create a collective dominant position in short-haul package holidays in the UK between the three leading tour operators, Airtours/First Choice, Thomson Travel Group plc and The Thomas Cook Group Ltd. The Commission argued that "…the substantial concentration in the market structure, the resulting increase in its already considerable transparency, and the weakened ability of the smaller tour

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[81] Commission Decision C (1999), Case No IV/M.1524 – Airtours/First Choice, recitals 139 - 147.
[82] *Ibid.*, recital 18.
[83] *Ibid.*, recitals 43 – 50.
[84] *Ibid.*, recital 194.

operators, and of potential entrants to compete will make it rational for the three major players that would remain after the merger to avoid or reduce competition between them, in particular by constraining overall capacity".[85]

4.1.3 The Court's Analysis

In the Airtours decision the CFI emphasised the importance of the Commission producing convincing evidence that the merger would create or strengthen a dominant position affecting the market negatively. The Court stated, "Where […] the Commission examines a possible collective dominant position, it must ascertain whether the concentration would have the direct and immediate effect of creating or strengthening a position of that kind, which is such as significantly and lastingly to impede competition in the relevant market […]. If there is no substantial alteration to competition as it stands, the merger must be approved…"[86] The Commission would also have to present convincing evidence, *inter alia* evidence of "factors playing a significant role in the assessment of whether a situation of collective dominance exists, such as, for example, the lack of effective competition between the operators alleged to be members of the dominant oligopoly and the weakness of any competitive pressure that might be exerted by other operators."[87]

4.1.3.1 Definition of the Relevant Market

The Court found that the definition given by the Commission on the relevant market as being short-haul package holidays in the UK was a reasonable one.[88]

4.1.3.2 Assessment of Market Power

In the Airtours' judgement the Court further developed the concept of collective dominance in EC competition law. In its earlier judgement in Gencore the Court had made statements about the possibility of the creation of collective dominance between interdependent parties on an oligopolistic market.[89] The Airtours' decision clarified the prerequisites for collective dominance. In its judgement the Court stated, in paragraph 61, that a collective dominance: "may […] arise as the result of a concentration where, in view of the actual characteristics of the relevant market and of the alteration in its structure that the transaction would entail, the latter would make each member of the dominant oligopoly, as it becomes aware of common interests, consider it possible, economically rational, and hence preferable, to adopt on a lasting basis a common policy on the market with the aim of selling at above competitive prices, without having to enter into agreement or resort to a concerted practice within the meaning of Article 81 EC and without any actual

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[85] Commission Decision C (1999), Case No IV/M.1524 – Airtours/First Choice, recital 56.
[86] Case T-342/99 Airtours v Commission, para 58.
[87] *Ibid.*, para 63.
[88] *Ibid*, para 46.
[89] Case T-102/96 Gencore v Commission. The Court stated that "there is no reason whatsoever in legal or economic terms to exclude from the notion of economic links the relationship of interdependence existing between the parties to a tight oligopoly" (para 276).

or potential competitors, let alone customers or consumers, being able to react effectively".

The Court also found that such a market position was primarily based upon three different conditions:

1. Each member of the dominant oligopoly must have the ability to know how the other members are behaving in order to decide if they are going to adopt the common policy or not. This requires the market to be transparent to some extent;
2. the tacit co-ordination between the members must be over time sustainable to be profitable, that is, there must be an incentive in order not to depart from the common policy on the market; and
3. the foreseeable reaction of current and future competitors, as well as consumers, would not jeopardise the results expected from the common policy.[90]

The Court found that the Commission had failed in proving that the result of the merger would be firstly a change of the structure of the relevant market in such a way that the leading operators would not act in the same way they had been acting in the past, secondly, that a collective dominant position would be created.[91]

Consequently, the Court found that the Commission had failed to prove that the three remaining operators had an incentive to cease competing with each other, that the Commission had not based its analysis on cogent evidence and that the decision contained manifest errors of assessment.[92] The Court concluded that the Commission had prohibited the merger without having proved to the requisite legal standard that the concentration would give rise to a collective dominant position to impede effective competition on the relevant market.[93]

4.1.4 Comments

The Airtours judgement is considered being a milestone in the development of the concept of collective dominance in EC competition law. There has been a shift in focus of economic analysis from the static assessment of structural features as the predominant test in the previous administrative practice to a dynamic forecast of the internal incentives and mechanisms of the affected market. In addition to the analysis of traditional indicators of market dominance, the Court thereby primarily paid attention to the issue of the economic rationality of tacit co-operation and the requirements of its lasting sustainability. This ruling has led to more legal certainty for undertakings involved in oligopolistic markets. The Airtours judgement made the

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[90] Case T-342/99 Airtours v Commission, para 62.
[91] *Ibid.*, para 293.
[92] *Ibid.*, paras 278 *et seq.*
[93] Loughran, M. *et al*, *Merger Control: Main developments between 1st May 2002 and 31st August 2002*, page 59.

Commission aware of the need for deeper analyses of the overall economic development as well as of specific circumstances of single concentrations.[94]

On June 18, 2003, MyTravel Group plc (“MTG”), formerly Airtours plc, brought an action against the Commission. MTG claimed that the CFI should order he Commission to pay MTG a compensation for damage for harm caused to it because the merger could not be finalised.[95]

4.2 Schneider Electric v Commission, Case T-310/01

4.2.1 Background[96]

On 16 February 2001 Schneider Electric SA, a French company, notified the Commission under the Merger Regulation of a public bid announced 15 January 2001 to take over LeGrand SA, another French company. Both companies produce and sell low-voltage electrical components, such as circuit breakers, electrical panels and switches. 98 per cent of the stock in LeGrand was acquired.

The majority of sales from both firms are directly to distributors, who then sell to panel builders and electricians. Schneider’s market shares for some of the products offered are high in France (80-90%) and moderately high in Italy (60-70%), Portugal (50-60%) and Denmark (70-80%).

Competitors to the merging entities are, on most markets, large multinational electrical component producers, such as ABB, General Electric, Matsushita and Siemens. Some of the competitors (for example ABB), are vertically integrated and thus perform installation of the produced products.

The proposed merger was found to have community dimension, and the Commission started an investigation. On March 30, 2001, the Commission initiated second phase proceedings under the Merger Regulation because of serious doubts as to the merger’s compatibility with the common market.[97] The Commission prohibited the merger on October 10, 2001 and refused a package of remedies offered by Schneider. On January 30, 2002, the Commission issued a Decision, ordering Schneider to divest its shares in LeGrand.

Following an action for annulment brought forward by Schneider on December 13, 2001, the CFI overruled the Commission’s prohibition decision. Using the fast track procedure, the CFI found errors and omissions in the Commission’s economic analysis, as well as a number of shortcomings in the Commission’s

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[94] Haupt, H., *Collective Dominance under Article 82 E.C. and E.C. Merger Control in the light of the* Airtours *Judgement*, page 444.

[95] Notice No 2003/C 200/51, Case T-212/03: Action brought on 18 June 2003 by MyTravel Group plc against the Commission of the European Communities, [2003] O.J. C200/28.

[96] Case T-310/01 Schneider Electric v Commission, para 13 – 60.

[97] Ragolle, F., *Schneider Electric v Commission: The CFI’s Response to the Green Paper on Merger Review*, page 176.

administrative process. The judgement was delivered on 22 October 2002. Because the divestiture decision thereby lacked legal ground, the CFI annulled this in another judgment the same day.[98]

4.2.2 The Commission's Analysis[99]

In its Decision of 10 October 2001, the Commission declared Schneider's acquisition of LeGrand as incompatible with the common market.[100]

4.2.2.1 Definition of the Relevant Market

The product market for low-voltage electrical components can be divided into a number of segments with unique characteristics.[101] Also, six categories of operators are found to be involved in the supply of, and demand for, the components concerned.[102] This definition of the relevant product market was agreed between the Commission and Schneider.

While Schneider argued that the geographical market traditionally was a national one, they indicated in their notification of the merger that several tendencies towards internationalisation were appearing on the market. Schneider claimed that the merged entity should be evaluated on the pan-European market.

A major point in the Commission's argument was that markets are national because of differences in regulations and standards as well as pricing structures. Reasons for defining national markets are *inter alia* barriers to entry, following normative differences for electrical equipment[103], and diverse traditions amongst end-users, notably esthetical considerations. Evidence of many different product variations within Europe indicated that several, smaller, markets existed within the Community.[104]

4.2.2.2 Assessment of Market Power

The Commission concluded that the proposed merger would adversely affect competition. One reason for this was that electricians were found to be "extremely brand loyal", working several years – if not their whole career – with one major brand. There were in turn two reasons for this; familiarity of equipment and issues relating to electrical safety.[105] The merger between

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[98] Case T-77/02 Schneider Electric v Commission.
[99] Commission Decision C (2001), Case No COMP/M.2283 – Schneider Electric/LeGrand.
[100] Article 1 of the Decision.
[101] *Ibid*., recital 14.
[102] These are Manufacturers (such as Schneider and LeGrand), Wholesalers, Switchboard assemblers, Installation engineers, Project managers (architects and construction companies) and End-users. A closer description can be found in sections A.2.2 through A.2.7 of the Decision, recitals 15 – 42.
[103] Legislation concerning electrical equipment is harmonised only partly.
[104] Commission Decision C (2001), Case No COMP/M.2283 – Schneider Electric/LeGrand, for example at recitals 268 and 359.
[105] *Ibid*., recital 489.

Schneider and LeGrand was thought to increase the performance of the combined brand, making it more attractive to the new clients who were yet to make their “life-long” brand commitment.

Also, there were barriers to entry in the markets in question. A new entrant had to be accepted by wholesalers and resist the competitive pressure on the market, while offering a somewhat complete range of products. The Commission claimed that entry by foreign firms into a national market was unlikely, due to the brand loyalty described above.[106]

Another reason for the negative effect on competition was that the price sensitivity for the segments of products concerned is low. When constructing a building, the price of electrical equipment often accounts for only a small part of the total cost of the building. The equipment in itself accounted for only around 20 per cent of the cost of the electrical installation, the other 80 per cent effectively representing cost of labour.[107] A market-wide price increase on the equipment at hand therefore had little effect on demand for new electrical installations.

The parties contested this with a study made by economic consultant NERA[108] showing that sales of a specific brand of products increased for a number of months following a promotion (i.e. reduction in price) to the detriment of competitors, indicating low cross-price elasticity of demand.

Here, the Commission claimed, Schneider mixed price sensitivity of demand (or demand side substitutability), estimated by means of a SSNIP test[109], with cross-price elasticity between manufacturers.[110]

On 14 September 2001 the notifying party presented a document containing proposed remedies to the Commission.[111] The aim of the remedies was to rectify any creation or strengthening of a dominant position as a result of the merger.

The Commission concluded that the commitments made by Schneider would not counter the anti-competitive results of the merger.

In response to the doubts expressed by the Commission, Schneider handed in an alternative set of proposed remedies on 24 September 2001. While the Commission found some merit within the proposition, it still found the proposed measures insufficient.[112]

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[106] Commission Decision C (2001), Case No COMP/M.2283 – Schneider Electric/LeGrand, recital 515.
[107] *Ibid.*, recital 517.
[108] NERA Economic Consulting (www.nera.com) is a Marsh & McLennan company (MMC). <www.nera.com>
[109] Chapter 3.1.4 above.
[110] Commission Decision C (2001), Case No COMP/M.2283 – Schneider Electric/LeGrand, recitals 519 – 520.
[111] *Ibid.*, recital 784.
[112] *Ibid.*, recital 850.

4.2.3 The Court's Analysis

Schneider brought an action for annulment[113] of the Commission Decision before the CFI. Three major arguments by Schneider were identified;[114]

(i) the Commission did not follow article 10 (3) of the Merger Regulation when it took more than four months to conclude the second stage of investigations,[115]

(ii) there were evident errors in the Commission's view on the impact of the concentration and the remedies proposed by Schneider, and

(iii) Schneider's right of defence was infringed when inconsistencies appeared between the statement of objections and the final Commission Decision.[116]

In its ruling on 22 October 2002, the CFI annulled the Decision declaring the notified merger incompatible with the common market. On the same day the CFI also annulled the Decision requiring Schneider to divest its shares in LeGrand.[117]

Pursuant to Article 10(5) of the Merger Regulation, the annulment of the prohibition Decision means that a new Commission investigation is to be commenced, and the time limits start again from the date of the judgement.[118]

4.2.3.1 Definition of the Relevant Market

The relevant product market was agreed between the parties as described above. The CFI accepted this definition.

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[113] In a separate document, Schneider requested that the CFI should use the expedited (or "fast track") procedure, in accordance with Article 76a of the Rules of Procedure. This was the first time the expedited procedure was used in a merger case, leading to a ruling after about ten months.

[114] Case T-310/01, Schneider Electric v Commission, para 73.

[115] Schneider observed that the four month period for the second stage merger investigations in Article 10(3) expired on 10 August 2001, i.e. before the Commission adopted its Decision on 10 October 2001. The result of this should be that the merger automatically be declared compatible with the common market. This plea was rejected by the CFI because of certain events effectively allowing the Commission to "stop the clock". Paras 74 – 113

[116] In its statement of objections, the Commission did not include a clear enough complaint about potential strengthening of Schneider's dominant position on the market for distribution panel-boards in France. This was later included in the Commission Decision prohibiting the merger. Ironically the Commission, in turn, claims that the plea for annulment made by Schneider is inadmissible because it is imprecise and does not allow the Commission to formulate a defence! The CFI finds that the Commission did not permit Schneider to assess the full extent of the competition problems resulting from the proposed merger. Therefore Schneider's rights of defence have been infringed. Paras 421 – 465

[117] Case T-77/02, Schneider Electric v Commission.

[118] The recommencement of procedure is documented in [2002] O.J. C279/22. This led to the Commission again being ready to commence second phase proceedings after once more rejecting Schneider's proposed remedies for the French market.

The Commission's analysis of the relevant geographic markets was rejected by the CFI, because the Commission used national data to deduct information about pan-European competition. However, the CFI accepted the Commission's claim that the merger would lead to dominance on the French market.

4.2.3.2 Assessment of Market Power

Schneider claimed there were errors in several different ways in the Commission's estimation of market power. For clarity, the following table shows also the position taken by the CFI in relation to the claims.

Schneider's claim		***CFI response***
Inconsistencies in the economic reasoning underpinning the analysis of the impact of the concentration.	Schneider claimed the low price sensitivity of overall demand could not be used as proof of the price sensitivity toward each manufacturer. Also, brand loyalty puts competitors to the merged entity in a better position than would otherwise be the case.	Schneider has not shown that the Commission was wrong to use the test of price sensitivity of overall demand. [para 142] *Plea rejected.*
Overestimation of the strength of the merged entity.	The Commission's approach was to define country by country the various product markets. Schneider from the outset of the investigation held that markets were pan-European. When analysing the impact of the merger on competition, the Commission relied on the merged entity's geographic coverage throughout the whole of the EEA.	While the merger would lead to competition problems in France and six other national markets, transnational effects on competition cannot be automatically deducted from this. The Commission has not proved these effects exist. [paras 177 – 179] *Plea accepted.*
Inconsistency in the analysis of the structure of competition at wholesaler level.	The market is characterised by significant buyer power on the part of wholesalers. They are capable of exercising an effective competitive pressure on the merged entity	Neither the fact that the merged entity will be an unavoidable trading partner for wholesalers nor their inability to exercise competitive constraints on it have been properly demonstrated. [para 230] *Plea declared founded.*
Errors in the analysis of the impact of the concentration on the various national sectoral markets referred to in the Commission's objections.	The Commission has drawn general, Europe-wide, conclusions from its investigation of the French market. Instead of analysing the pan-European market, the Commission confined itself to general arguments relating to the incomparably broad product	"It follows that the Commission has again overestimated the economic power of the new entity on the national sectoral markets ---" [para 256] "--- the Commission was wrong to take as its

	range offered by the merged entity.	reference point the entire range of products and brands which the merged entity will have throughout the EEA for the purpose of assessing the entity's economic power on each of the various national sectoral markets affected by the transaction.” [para 262] *Plea accepted.*
Manifest errors of assessment in the analysis of the impact of the concentration on certain national markets for panel-board components.	The Commission refused to take into account the integrated sales branch of companies such as ABB and Siemens, two of the leading competitors to the merged entity.	The Commission underestimated the market power of the merged entity’s two main competitors. [para 296] *Plea accepted.*
Incorrect analysis of the impact of the concentration on the Danish markets for final panel-board components.	The new entity will not have a dominant position in Denmark or unrivalled power on certain sectoral product markets.	There is not sufficient evidence that the merger would result in a dominant position on the relevant Danish sectoral product markets. [para 349] *Plea accepted.*
Errors in the analysis of the impact of the concentration on the Italian markets for distribution and final panel-board components.	Keen competition in a market cannot be taken as indicative of the existence of barriers to entry.	It has not been proved to the requisite legal standard that the merger results in the creation of a dominant position on certain Italian sectoral product markets. [para 402] *Plea accepted.*

4.2.4 Comments

The Commission argued that the merged entity would gain enough market power to be able to profitably raise prices. The evidence for this was not enough to reach the standard of proof set by the CFI. Almost all the substantive arguments put forward by Schneider were upheld by the Commission.

Especially the fact that the Commission investigated market power on national markets and then drew Community-wide conclusions from this led to the outcome in the case.

It is also interesting to note that, although the Commission Decision was overruled in record time thanks to the fast-track procedure, in the end Schneider did not keep the stock in LeGrand. According to a press release from

Schneider, the reasons for this were the lengthy merger process and the hostility of the LeGrand management towards the takeover.[119]

Swedish newspaper Dagens Industri reported on October 22, 2003, that Schneider sued the Commission for damages of €1.6 billion because the merger could not be finalised.[120]

4.3 Tetra Laval BV v Commission, Case T-5/02

4.3.1 Background

On 27 March 2001, Tetra Laval SA ("Tetra"), a privately held company incorporated under French law and a wholly owned subsidiary of Tetra Laval BV, a holding company in the Tetra Laval Group, announced a public bid for all outstanding shares in a French publicity quoted company, Sidel SA ("Sidel"). Tetra Laval was considered the world leading company in carton packaging and Sidel was involved mainly in PET packaging equipment.

The same day, Tetra Laval SA acquired 9.75 per cent of the shares in Sidel from another company, Azeo, and 4.19 per cent from Sidel's directors.

Pursuant to the bid, Tetra acquired 81.3 per cent of the outstanding shares in Sidel and after the closing of the bid Tetra acquired additional shares and the holdings were at the end approximately 95.20 per cent of the shares and 95.93 of the voting rights in Sidel.

On 18 May 2001 this operation was notified to the Commission and on 30 October 2001, the Commission adopted a Decision pursuant to Article 8(3) of the Merger Regulation where the Commission prohibited Tetra to acquire Sidel ("the Prohibition Decision"[121]). In its decision the Commission concludes that the notified concentration would both create and strengthen its dominant position on the relevant market and was therefore declared incompatible with the common market. The Commission based its Prohibition Decision on the likelihood that the two firms, through leveraging, would have negative effect on the relevant market.

On 30 January 2002 the Commission ordered Tetra to separate itself from Sidel.[122]

In Case T-05/02 the Court was asked to annul the Commission Decision declaring the concentration Tetra Laval/Sidel to be incompatible with the common market and the EEA Agreement.[123]

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[119] Press release dated December 3, 2002, "Schneider Electric has decided to sell LeGrand to the KKR-Wendel Investissement consortium". Found at <www.schneider-electric.com>.
[120] Dagens Industri, 22 October, 2003, page 14.
[121] Commission Decision C (2001), Case No COMP/M.2416 – Tetra Laval/Sidel.
[122] Commission Decision C (2002), Case No COMP/M.2416 – Tetra Laval/Sidel.
[123] The Court was also asked to annul the Commission Decision on the basis that the Commission had failed in complying with procedural rules. Tetra argued that it had been,

Even though Tetra and Sidel were involved in different markets, carton packaging and PET packaging equipment respectively, the Commission argued that these markets were closely neighbouring markets, and that the merger would create a market structure where the merged entity would leverage its dominant position in carton in order to turn its leading position in PET packaging equipment into a dominant one. The merger would also create an even stronger dominant position for Tetra in the carton market by eliminating its competitor Sidel. Even though Tetra offered remedies in order to maintain competition the Commission found these remedies insufficient.[124]

Like in the previous cases the CFI annulled the Commission's decision to prohibit a merger on the basis that the Commission had not been able to prove that the modified merger would give rise to significant anti-competitive conglomerate effects. The Commission had not been able to prove that the merger would create a dominant position on one of the various relevant PET packaging equipment markets or that Tetra's current position on the aseptic carton markets would be strengthened.[125] The Court also stated that the "…Commission committed a manifest error of assessment in prohibiting the modified merger on the basis of the evidence relied on in the contested decision relating to the foreseen conglomerate effect."[126]

4.3.2 The Commission's Analysis

While investigating the market and analysing the same, the Commission found that the merger between Tetra and Sidel could strengthen Tetra's dominant position in the market for aseptic carton packaging machines and aseptic cartons and the merger could also create a dominant position in the market for PET packaging equipment and, in particular SBM (stretch blow moulding) machines in the *sensitive* product end-use segments; LPDs (liquid dairy products), juices, FFDs (fruit flavoured still drinks) and tea/coffee drinks.[127]

Furthermore the Commission found that Sidel had a leading position in the market of SBM machines of high and low capacity[128] and a leading position in other PET packaging equipment, in particular aseptic filling machines, in

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unlawfully, denied access to the file of an expert report and to the responses to a market survey the Commission had made. Tetra further argued that the Commission had failed in its assessment of the relevant market, as leveraging was not possible. To these arguments the CFI concluded that Tetra had had access to the files and that a summary of the surveys, of which Tetra had been granted access, were sufficient information. The Court further confirmed that the Commission was entitled to assess the possible anti-competitive conglomerate effects of the merger, even though Tetra and Sidel were active on two different markets. The Court held that the Commission had shown evidence of that the merged entity would have the ability to engage in leveraging practices. Case T-5/02 Tetra Laval v. Commission, para 199.

[124] Commission Decision C (2001), Case No COMP/M.2416 –Tetra Laval/Sidel, recitals 213 *et seq.*

[125] Case T-5/02 Tetra Laval v Commission, para 336.

[126] *Ibid.*, para 336.

[127] Commission Decision C (2001), Case No COMP/M.2416 –Tetra Laval/Sidel, recital 213.

[128] *Ibid.,* recital 248.

secondary equipment and associated services.[129] The Commission found that Tetra held 60 – 70 per cent of the overall market for packaging in both aseptic and non-aseptic cartons and kept also a dominant position in the carton packaging market as a whole.[130] The merger would create a market structure where Tetra's already dominant position in the aseptic carton packaging market would be retained and strengthened by eliminating Sidel as a competitor.[131] The Commission explained its view by the fact that the two different markets were closely neighbouring markets with a common pool of customers; "…both PET and carton will be used in all the common PET-carton end-use product segments, (LDPs, juices, FFDs, tea/coffee drinks) as beverage companies will increasingly want to have a mix of packaging materials…".[132]. The Commission's analysis further shows that the future "…merger would enable the merged entity to acquire a dominant position in PET by leveraging its dominant position in carton packaging, having a first mover advantage in the customer base coupled with strong market shares, unparalleled range of products and technology, and unassailable international presence…".[133]

4.3.2.1 Definition of the Relevant Market[134]

When defining the *relevant product market* the Commission concentrated its analysis on the segments of the liquid food packaging industry in which Tetra and Sidel were primarily active. These segments were in particular PET packaging and carton packaging. The Commission stated that PET packaging was a distinct product market but decided to look at the interplay between carton and PET and the future growth of PET in the traditional carton end-use segments, as the Commission found that PET and carton shared the same product segments. The Commission emphasised that PET was a suitable material for the packaging of all the products that had been traditionally packaged in carton and that PET might potentially provide an alternative competing material for the entire spectrum of carton-packed products[135]. The Commission expected PET to reach 10 – 15 per cent in fresh milk and 25 per cent in flavoured and other dairy beverages within the next couple of years. For the overall juice market the Commission believed that PET would reach at least 20 per cent of that market in the EEA.

With regard to the competition in overlapping products the Commission found that the carton packaging system and the PET packaging system formed

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[129] *Ibid.*, recital 259.
[130] Commission Decision C (2001), Case No COMP/M.2416 –Tetra Laval/Sidel, recital 214.
[131] *Ibid.*, recital 330.
[132] *Ibid.*, recital 331.
[133] *Ibid.*, recital 331.
[134] The definition of the relevant market for products related to the Tetra Group has been examined before, for example in Commission Decision C (1991) Case No IV/M.68 - Tetra Pak/Alfa-Laval, and in Case C-333/94 Tetra Pak v. Commission [Tetra Pak II (ECJ)] which was an appeal of the Judgement of the CFI in Case T-83/91, Tetra Pak v. Commission [Tetra Pak II (CFI)], an action for annulment of Commission Decision C (1992), Case No IV/31.043 [Tetra Pak II (Commission)].
[135] Commission Decision C (2001), Case No COMP/M.2416 –Tetra Laval/Sidel, recitals 57 – 58.

distinct relevant product markets but the Commission further stated that this might change in the future.[136]

Regarding the PET packaging systems, the Commission stated that, for SBM machines, separate relevant product markets existed for each distinct group of customers on the basis of end-use, in particular in the four sensitive beverage segments; LDPs, juice, FFDs and tea/coffee drinks. The Commission further distinguishes the different barrier technologies to form part of the same product market.[137] There are two distinct markets for aseptic and non-aseptic PET filling machines, whilst PET preforms (the pre-production tubes used to make the bottles) constitute yet another distinct market.[138]

With regard to the carton packaging system both the Commission and Tetra considered the relevant product market consisting of four distinct markets: aseptic carton packaging machines, aseptic cartons, non-aseptic carton packaging machines and non-aseptic cartons.[139]

Both Tetra and the Commission agreed on the definition of the relevant geographic market for PET packaging equipment (including SBM machines, barrier technology and filling machines) as being the EEA, as all suppliers are active throughout the EEA, and capable of providing their equipment on a cross-border basis. With regard to carton packaging machines the CFI had already in a previous case (Tetra Pak II) defined the relevant geographic market as the whole of the Community.[140] While there had been no significant changes on the market since the Court's ruling, the Commission found no reason to change the Court's previous decision.[141]

4.3.2.2 Assessment of Market Power

The Commission argued that the merged entity would use pressure, by leveraging, leading to tied sales and sales that would bundle equipment and consumables for carton packaging jointly with PET packaging equipment. The merger would also lead to that the merged entity would offer incentives, that would lead to predatory pricing, price wars and loyalty rebates.[142]

The position of the merged entity in the relevant markets would likely create barriers of entry, minimise the importance of existing competitors and lead to a monopolistic structure for the whole market for aseptic and non-aseptic packaging of sensitive products in the EEA.[143] The Commission argued that the position of Sidel, while already strong "…would reach the level of

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[136] *Ibid*., recital 163.
[137] *Ibid*., recital 198 *et seq.*
[138] *Ibid*., recital 204 *et seq.*
[139] *Ibid*., recital 188.
[140] Case C-333/94, Tetra Pak v. Commission, paras 86-99.
[141] Commission Decision C (2001), Case No COMP/M.2416 –Tetra Laval/Sidel, recital 210 *et seq.*
[142] Commission Decision C (2001), Case No COMP/M.2416 –Tetra Laval/Sidel, recital 364.
[143] *Ibid.*, recital 214.

dominance through the leveraging of the merged entity's dominant position in aseptic carton packaging equipment and aseptic cartons…"[144]

Consequently, the Commission concluded that the carton and PET packaging equipment markets were two separate markets but that they were closely associated. The Commission made the assessment that because of Tetra's dominant position in the carton packaging market Tetra would also have the possibility of leverage its position from the carton into the PET packaging equipment market. Thus, the merger would have a dominant position in the PET equipment market for sensitive end-products.[145]

4.3.3 The Court's Analysis

4.3.3.1 Definition of the Relevant Market

The Court noted that the Commission's definition of the relevant markets was virtually undisputed by Tetra. Thus, the Court found it necessary to distinguish the SBM machines market (divided into low- and high-capacity machines); the barrier technology market; the PET-filling machines market (aseptic and non-aseptic machines); the PET preforms market; and also the markets for auxiliary equipment, distribution packaging equipment and services relating to various relevant sectors.[146] Both parties also agreed on the relevant geographic market as being the EEA. The Court was of the same opinion.[147]

4.3.3.2 Assessment of Market Power

When the Court had distinguished the relevant markets, it started analysing the temporal aspects of the conglomerated effects and also the aspects relating to the specific nature of these effects. The Court found that "…in principle, a merger between undertakings which are active on distinct markets is not usually of such a nature as immediately to create or strengthen a dominant position due to the combination of the market shares held by the parties to the merger".[148] Furthermore the Court stated that if the Commission would be able to "…conclude that a dominant position would, in all likelihood, be created or strengthened in the relative future…" and that it would lead to the impediment of effective competition on the market, the Commission would have the right to prohibit the merger.[149]

The Court also addressed the importance of proof and evidence with regard to conglomerate effects. Conglomerate–type mergers are generally seen as having a neutral, or even beneficial, effect on the market, which makes it very important for the Commission to examine the proofs of anti-competitive

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[144] *Ibid.*, recital 263.
[145] *Ibid.*, recital 328.
[146] Case T-5/02, Tetra Laval v. Commission, para 189.
[147] *Ibid*, paras 37 – 38.
[148] *Ibid*, para 150.
[149] Case T-5/02, Tetra Laval v. Commission, para 153.

conglomerate effects thoroughly and to present convincing evidence of such effects.[150]

The Court found that there was a possibility of leveraging. The reasons for this was, *inter alia* that Tetra, holding a very strong dominant position in the aseptic carton market, would be able to lure manufacturers of sensitive products into PET. Tetra and Sidel also had financial strength and Tetra had a very good reputation on the carton market like Sidel had a very good reputation on the PET market. Altogether these factors made it possible for the merged entity to engage in leveraging practices.[151]

The Commission, in respect of the aseptic carton market, argued that the leveraging would manifest itself by predatory pricing, price wars and granting of loyalty rebates. The Court dismissed these arguments and stated that they were all actions of abuse of a dominant position, thus illegal actions. Since Tetra already had a dominant position on the market of aseptic cartons the examples given by the Commission of an abuse of a dominant position would probably not be more likely to incur only because of the merger. The Commission should have taken into account the possibility that such a conduct could be reduced or eliminated because of the illegality of such a conduct.[152]

The general conclusion of the Court was that "…the contested decision does not establish to the requisite legal standard that the modified merger would give rise to significant anti-competitive conglomerate effects. In particular, it does not establish to the requisite legal standard that any dominant position would be created on one of the various relevant PET packaging equipment markets and that Tetra's current position on the aseptic carton markets would be strengthened".[153] The Court also stated that the "…Commission committed a manifest error of assessment in prohibiting the modified merger on the basis of the evidence relied on in the contested decision relating to the foreseen conglomerate effect."[154]

Furthermore, the Commission should have taken into account that Tetra offered several remedies in order not to distort competition.[155] As the Commission did not make such an assessment, the Commission based its analysis of leveraging exclusively on conduct "…which would, at least probably, not be illegal".[156] The Court also stated that the Commission had failed in providing convincing evidence on the growth prospects of PET in respect of milk and fruit juice.[157] The Court further held that price discrimination by end-users shown by the Commission to exist in the SBM machine market, could not be relied upon, based on the fact that such a practice would be illegal for a dominant merged entity. Further, the Commission

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[150] *Ibid.*, para 155.
[151] *Ibid.*, paras 197 and 199.
[152] *Ibid.*, para 217.
[153] *Ibid.*, para 336.
[154] *Ibid.*, para 336.
[155] *Ibid.*, para 161.
[156] Case T-5/02, Tetra Laval v. Commission, para 162.
[157] *Ibid.*, paras 203 e*t seq.*

underestimated the importance of the merged entity's competitors on the carton and the PET markets and the interaction of PET and carton with other packaging materials such as glass, cans and high density polyethylene bottles where the merged entity would not be present or would only have a modest position.[158]

4.3.4 Comments

CFI closely examined the Commission's arguments concerning conglomerate effects and leveraging. The Court found that the Commission could not merely assume that merging parties would engage in behaviour that would impede competition; instead, the Commission has to thoroughly analyse and prove or at least have reassuring evidence of the actual likelihood of such behaviour.

Just as the Schneider / LeGrand case, the Tetra Lava case was dealt with under the CFI's expedited procedure rules and the CFI ruling lead to the allowance of the merger of Tetra Laval and Sidel. The Commission, after having re-assessed the case, cleared the merger on 13 January 2003 but in its clearance decision they the outcome of its appeal of the CFI judgement made on 8 January 2003, the ECJ could permit the Commission to reconsider its clearance.

4.4 Conclusions

The Airtours-case clarifies the conditions for collective dominance on the relevant market; the market in question must be sufficiently transparent; provide opportunities to detect and punish attempts to "cheat" on any collusive common policy; and the foreseeable reaction of current and new competitors will not have an effect of the common policy on the market.

This is the first case where CFI clearly imposes an extensive standard of proof on the Commission concerning the factual and economic evidence to base its assessment on. The Court found that the Commission had not presented convincing evidence that there would be collective dominance on the relevant market and concluded that the Commission's Decision was lacking cogent evidence and was based on errors of assessment.

After the Airtours-case the Commission now has a guideline on how to investigate possible collective dominance and collusive behaviour on a market. One can expect that the Commission, in the future, will be more thorough in its assessments regarding the influence a merger will have on an oligopolistic market.

In Schneider / LeGrand the Commission made the error of first investigating competition in national markets and then applying this broadly to a community-wide market. The CFI required more information about transnational market conditions.

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[158] *Ibid.,* paras 213, 237 and 244.

One reason for this behaviour on the part of the Commission might be that the more detailed econometric data available was national. Because the French market clearly showed signs of limited competition, it may have been tempting to assume that that went for other markets as well (although no data was available to support this view).

While demand side substitutability is identified as a legitimate competitive constraint in the Commission Notice on market definition, it is interesting to note that the Commission underestimated the constraint exercised by wholesalers on the relevant market. The CFI found that Schneider's claim of significant buyer power on the part of wholesalers was founded. The CFI found that Schneider would have a high market share, but not necessarily enough market power to dominate the market.

After Schneider / LeGrand, we can expect more detailed analysis of markets by the Commission. This could also lead to higher demands for econometric data from the merging parties already at the outset of the merger review process.

In the Tetra Laval-case the CFI criticised the Commission's factual findings and its analysis of market power. The CFI also held that the effect of most conglomerate mergers is neutral, or sometimes even beneficial, thus the Commission has to provide convincing evidence if it considers this is not the case.

The Commission presumed that Tetra Laval would engage in leveraging practices, without being able to prove the likelihood of such behaviour. The Commission was heavily criticised for committing a manifest error of assessment in concluding that the merged entity could acquire a dominant position by 2005 on the PET packaging equipment market through leveraging its position on the liquid carton packaging market as the Court found a number of factual errors in the Commission's assessment.

Some of the alleged behaviours would also constitute an abuse of a dominant position under Article 82, thus be illegal. The Commission failed in proving that despite the remedies for illegal behaviour and the preventive effects these might have, Tetra Laval would engage in such illegal conduct.

The Tetra Laval-case shows that the Commission has to provide convincing evidence on that conglomerate mergers will have a negative effect on competition. It is not enough to merely presume that parties will, through leveraging, achieve a dominant position on the relevant market, or that there is a risk of collusive behaviour after the merger.

The Airtours-case, Schneider / LeGrand and the Tetra Laval-case put a rigorous standard of proof on the Commissions analysis. In the future one can expect that the Commission will be careful in its assessments and be sure to provide the merging parties and the Court with evidencing proof that the merger will have negative consequences on the relevant market before prohibiting a proposed merger.

5 Reform of Merger Review

The negative outcome, from the Commission's perspective, of the Airtours-case, Schneider / LeGrand-case and the Tetra Laval-case has lead to the initiation of reforms.

The Commission announced in December 2002 a proposal[159] reforming merger review on a number of points.

One of the points being discussed is whether the currently used dominance test could provide effective control of competition in certain situations of oligopoly or if the substantial lessening of competition test, SLC, used in the US, UK and Ireland would be a more effective test.

The Commission's proposal is to retain the dominance test but to clarify the concept of dominance under the Merger Regulation by inserting a new Article 2(2):

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

In a speech delivered in Brussels in late 2002[160], the Commissioner for Competition Policy Mario Monti also described a number of changes to how mergers will be handled within the Commission in the future.

Among these changes is a strengthening of the economic capabilities of the Competition Directorate-General. Commissioner Monti proposed the creation of a position of Chief Competition Economist, with part time duties in the economic review of notified mergers.[161]

Also, he proposed systematic use of an independent panel of experienced officials reviewing the Commission's case with a fresh pair of eyes in Phase II merger cases, a so called "peer review".

In the past, notifying parties have complained that competitors can bias the Commission's decisions unfavourably because their views of the competitive situation can stand unchallenged until late in the review process. Commissioner Monti proposed that parties would have earlier access to the Commission's file, including access to complaints by competitors. This will increase the transparency of the review process.

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[159] Proposal for a Council Regulation on the control of concentrations between undertakings, [2003] O.J. C20/4.
[160] Speech by Prof. Mario Monti, SPEECH/02/545, 7 November 2002, Brussels, found at <europa.eu.int>
[161] A Chief Competition Economist has been employed since June 2003.

These reforms might lead to a speedy process of evaluation of a merger by the Commission and also to a more accurate assessment of its effect on competition on the relevant market.

6 Conclusion

Our purpose with this thesis has been to investigate the hypothesis that the recent case law from the Court of First Instance will lead to change in the way the Commission reviews mergers. Based on the public versions of the three cases Airtours, Schneider / LeGrand and Tetra Laval, this certainly seems true.

It is however hard to predict the exact future changes in the appraisal of mergers. The only thing that is certain is that changes are needed and that the current system is currently changing and will continue to change. The reason for this is not only a number of cases overruling decisions taken by the Commission but also the fact that EC competition law has evolved over the years in time to the development of society in general and the growth of economy in particular.

The high standard of proof imposed on the Commission by the CFI will most likely lead to more thorough investigations made independently by the Commission. With the introduction of peer review (or "devil's advocates") as part of the standard Commission investigation hopes are up that the Commission will become better at making correct estimation of markets. Including a renowned economist on staff, albeit for a limited period of time, in the Commission is an important signal from the Commission that economics and econometrics will be a strong focus in the years to come.

In the past, the Commission has been criticised for defining the relevant market with a bias towards more narrow markets. This increases the likelihood of finding an undertaking dominant, simply because the market is smaller. With more focus on econometric analysis and empirical tests, the Commission will hopefully put an end to this criticism and the investigations made will be supported by substantial economic calculations and estimations of the relevant market and the impact the proposed merger will have on this market.

For example, in Schneider / Legrand, shipment studies, trade pattern analysis and maybe even transport cost studies could have been used extensively by the Commission to prove the relevant geographical market and to investigate the Community-wide effects of the merger.

Given that six of the national markets concerned showed signs of negative effects on competition by the merger, it is not entirely unlikely that negative effects could have been shown also at Community level had this been the focus of the Commission.

While some of the data necessary to support these tests may be produced or gathered by the Commission, it is likely that it will be required of the merging parties at the outset of the merger review. We can expect companies specialising in econometric analysis to be hired more frequently to produce convincing market analysis for the parties.

The usage of theory models such as the ones described in Chapter 3 would help both the Commission and merging undertakings argue their cases. By using

these economical theories and models the investigations performed by the Commission will meet a higher legal and economical standard while increasing transparency in the decision-making process.

One problem with the appraisal of mergers that is not affected by the introduction of novel theories or techniques is that the input data for these theories might not be available. Also, if unknown variables, such as shock, exist when data is available this can have a negative effect on the analysis.

In the Airtours-case and the Tetra Laval-case the CFI imposed an extensive standard of proof on the Commission in its assessment of the proposed mergers. As the relevant markets in both cases were not in dispute as such, these cases are particularly interesting in view of collective dominance and leveraging.

The Airtours-case contributed to clarifying the prerequisites of when a merger is likely to have negative effect on competition on a market where there are only few competitors left, in respect of collective dominance. The Commission has to show substantial evidence that the remaining parties on the relevant market after a proposed merger would engage in collusive behaviour leading to the impediment of competition on that market.

The Tetra Laval-case discussed if there was a possibility for a merged entity to use its market power held in one relevant market on another relevant market where it was active, though there were distinct relevant markets. The Court clearly stated that a merger could through leveraging create or strengthen a dominant position. However, in this case the Commission failed in its assessment and lost the case by not providing the Court with convincing evidence that the merged entity would have such a negative influence on competition.

Consequently, well-supported analysis from the Commission is necessary. If the Commission shows convincing evidence of the proposed merger having negative effects on competition, fewer firms will appeal the Commission's decision. We will have a stronger legal security with regard to merger cases and hopefully a more efficient competition policy system than today.

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