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Concentrations in EC Competition Law - the Impact of the Merger Regulation. A Case Study

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Summary

The geographic market definition is crucial for the compatibility assessment and may affect the outcome of a case in a determinant manner as illustrated in the *SCA/MetsäTissue* – case and the *Volvo/Scania* – case. The factors assessed by the Commission and their indication of a wide respectively a narrow market definition has been identified and laid out in a table. In addition, the considerations of the Commission when assessing a concentrations compatibility with the Common Market has been identified and an overview of the factors detriment for a finding of dominance has been outlined. Furthermore, the changes in the Commissions appraisal of concentrations, due to the new Merger Regulation have been examined. The analysed changes are specifically the altered compatibility test and the introduction of the appraisal of efficiency gains. Moreover, the econometric tool of merger simulation has been discussed as well as the possibility of utlising the American model under the Merger Regulation. Finally, the *SCA/MetsäTissue* – case and the *Volvo/Scania* – case was analysed in the light of the new Merger Regulation raising questions as to whether they would be found compatible with the Common Market.

Preface

I am very grateful towards everyone who has helped and encouraged me in the process of writing my master thesis. I would like especially to thank Mikael Schmidt, Vice President of Legal Affairs at SCA Packaging, Brussels, for providing an appealing subject matter to base my master thesis on. I would also like to thank my family and friends for their support throughout the completion of this thesis. Special thanks to Jamie Gustafsson, student at Suffolk Law School in Boston, for proofreading my master thesis and to my friends at Juridicum for making the writing period enjoyable.

Hanna Hjalmarsson
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Abbreviations

CFI	Court of First Instance of the European Communities
EC	The European Communities
ECJ	The European Court of Justice
EEA	European Economic Area
HHI	Herfindahl-Hirshmann Index
R & D	Research and Development
SSNIP	Small but Significant Non-transitory Increase in Price
SLC	Substantial Lessening of Competition
US	The United States of America

1 Introduction

Economic theory tells us that competition is desirable from a societal perspective. Mergers and acquisitions can disturb effective competition in the market. In order to protect effective competition and ultimately the consumers from increased prices, less variety of products, lower quality of products and reduced innovation, the European Community employs a merger control system.

The system of merger control provides for an appealing subject to base a thesis on due to its impact on the undertakings effected by it and because of the recent development in the area.

The merger control system can induce far-reaching consequences for the undertakings concerned by rendering the transaction incompatible with the Common Market and ultimately prohibited. Therefore, a desire to comply with the Merger Regulation exists in order to get a transaction cleared. The Commisions view on the compatibility of a concentration with the Common Market is contingent upon the criterion of effective competion. Effective competition is fundamentally an economic concept and it is therefore necessary to know how the Commission conducts its economic analysis of a concentration in order to understand decision making under the Merger Regulation.

The merger control system has evolved rapidly in the recent years introducing a new compatibility test and the possibility to consider efficiencies. It is thus of importance to asses how these changes have effected the appraisal of concentrations under the Merger Regulation.

With reference to the current development and the central position the system has for the undertakings involved, the thesis will, overall, examine two central problems: the determination of the relevant geographic market and the assessment of a concentrations compatibility with the Common Market.

1.1 Problem and Purpose

The definition of the geographic market is a tool that enables the Commission to build a framework in order to determine the likely market power of a concentration. The geographic market definition is thus a key step in the appraisal of concentrations under the Merger Regulation and crucial for determining a concentrations compatibility with the Common Market. The reason is as follows: narrowly defined markets will typically lead to a higher degree of market power. Thus, the widest possible market definition is desirable from the concerned parties' point of view. In order to argue for a wide geographic definition it is necessary to analyse the factors

the Commission uses in assessing the scope of the geographic market. The following problem can be posed:

1. What factors influence the assessment of the relevant geographic market?

When the scope of the geographic market has been determined, the Commission is able to appraise a concentrations compatibility with the Common Market. From an economic viewpoint, there are a number of factors to measure the effect of a merger on market conditions. Thus, it is of importance to examine these factors. The following problem can be posed:

2. What factors influence the compatibility assessment?

In order to find an answer to the posed problems the thesis will analyse case law and literature regarding the old Merger Regulation. In addition, a case study will be performed; the *SCA/Metsä Tissue*- case and the *Volvo/Scania* – case will be examined in order to illustrate the Commissions appraisal of concentrations. However, as a new Merger Regulation came into force in 2004 it is of importance to examine whether the new Merger Regulation has changed the assessment of the geographic market and the assessment of a concentrations compatibility with the Common Market. The following problem can thus be posed:

3. Has the new Merger Regulation changed the assessment of the geographic market and the determination of a concentrations compatibility with the Common Market, and if so, how?

The new Merger Regulation has the objective of improving the effectiveness of the Merger control by taking into account a greater economic complexity which necessitates a heightened level of sophistication in the economic analysis of the cases before the Commission. Thus following problem can be posed;

4. Does the new Merger Regulation fulfil its objectives?

Thereafter the following questions can be posed:

5. Would the acquisition of Metsä Tissue by SCA and the acquisitions of Scania by Volvo be found compatible with the Common Market, in the light of the new Merger Regulation?

Each case before the Commission is assessed on its specific individual merits involving a complex economic based analysis. The analysis is in turn based on a combination of factors and the weight of each factor depends on the circumstances of the specific case before the Commission. Therefore, it would be imprudent to assume a single factor in one case will lead to the same conclusion in another case. This results in a lack of certainty and predictability in the application of the Merger Regulation. It is however

possible to generalise and identify a number of the most important factors the Commission will take into account in its appraisal of a concentration. The purpose and ambition of this thesis is to identify these factors; the general indicators of importance for the determination of the scope of the geographic market and the assessment of a concentrations compatibility with the Common Markets, as well as presenting the analytical approach used by the Commission in its appraisal of horizontal mergers and acquisitions

When the Commission appraises a concentration under the Merger Regulation, they routinely use economic analysis and studies as a tool in their assessment. The economic techniques applied by the Commission will be presented and outlined as to how they aid the Commission in its appraisal and what the outcome of the models implies. However, the reader is asked to bear in mind that this thesis does not claim to be an economic thesis and that the models are examined from a legal perspective. The reader is moreover, presumed to be a law student with little or some knowledge about economic theory.

1.2 Methodology and Material

This thesis is based on a traditional legal method of descriptive and analysing characteristics by examining de lege lata in order to derive an answer to the posed problems.

The method is also comparative as to its characteristic, examining the old and the new Merger Regulation. For the purpose of simplicity, the old Merger Regulation provides for the point of reference in chapter 2-5, whereas the new Merger Regulation will be referred to only when the approach remains the same. Thereafter, the substantial changes that alter the assessment of concentrations as well as modifications and clarifications will be examined in chapter 7.

When writing this thesis the old and the new Merger Regulation, the Commission official documents, its Notices and Guidelines issued by the Commission have been analysed. The Notices and Guidelines are regarded as so-called soft law and have strictly no binding legal effect but they are assigned importance due to the fact that they indicate the Commissions view on key provisions and concepts used in the Regulation and how the Commission has and can be expected to apply the Regulation.[1] However, the natural emphasis has been on the analysis of the Commission's decisions, which provides a useful point of reference in explaining the past, present and future assessment of the Commission's appraisal of concentrations. Unfortunately, the Commission has not yet taken any Article 8 decision under the New Merger Regulation and, therefore, a strictly theoretical approach has been applied in this respect. Moreover, literature

[1] Cook, p. 7.

regarding EC competition law, economic literature and articles have provided additional sources of information. The literature has generally been of an overall characteristic and finding literature providing an in-depth analysis of the appraisal of concentrations has posed a problem. Conversely, the Commission's Competition Policy Reports, "Merger Control in the European Union" written by Navarro et al, and "The EC Merger Regulation" written by Lindsay have provided for the in depth analysis needed. In addition, the various articles and "The Economics of EC Competition Law" written by Bishop and "The Role of Economic Analysis in the EC Competition Rules" written by Hildebrand were helpful resources concerning the economic approach.

In order to facilitate for the reader, a running analysis with concluding remarks is incorporated in the end of chapters, in order to avoid repetition in chapter 8.

1.3 Outline

The thesis consists of five parts. *Part I* consists of chapter two and three building the structural framework for the thesis. Chapter 2 lays out the decision making framework of the Merger Regulation and chapter 3 outlines the appraisal of concentrations. *Part II* consists of Chapter 4 and 5. The determination of the scope of the relevant geographic market is outlined in chapter 4 and Chapter 4.3 addresses the first posed problem. Chapter 5 examines the Commissions appraisal of a concentrations compatibility with the Common Market and chapter 5.6 answers the second posed problem. *Part III* consists of Chapter 6 and the case study. *Part IV* examines the new Merger Regulation in chapter 7 and answers the third and fourth posed problem in Chapter 7.3. *Part V* consists of Chapter 8 and answers the fifth and final posed problem as well as conducting a general discussion.

1.4 Delimitation

Certain delimitations are made to narrow down the rather wide scope of the presentation. The *first* delimitation concerns the type of dominance a concentration might give rise to; single firm dominance and collective dominance. [2] The majority of the notified concentrations result in single firm dominance and therefore, this will be the focus of the thesis. The *second* delimitation concerns the procedural rules[3] governing the Merger

[2] As to the assessment of horizontal concentrations creating collective dominance, see the Draft Notice, paras 25-69, the Guidelines, paras 39-57, XXIXth Report, p. 62-67, Bishop, pp. 150, Cook pp. 168 and Lindsay pp. 325 for an in depth examination and assessment of collective dominance.

[3] As to the procedural rules, see the Commission Regulation (EC) No 802/2004 implementing Council Regulation (EC) no 139/2004, the "Implementing regulation" and its annexes Form CO, Short Form CO and Form RS as well as the Commission Notice on a simplified procedure for treatment of certain concentrations under Council Regulation (EC) No 139/2004, OJ 2005 C56/03 and The DG Competition Best Practices on the conduct of

Regulation and the referral system, which provide an optimal allocation of cases between the national authorities of Member States.[4] An examination of the procedural rules and the referral system falls, however, outside the scope and purpose of this thesis and will not be examined. The *third* delimitation concerns the scope of the Merger Regulation, more specifically the definition of the relevant product market, ancillary restraints, the calculation of market shares, the failing firm defence and remedies.[5] Although a comprehensive study of these subjects would surely be of great merit to companies planning a merger or acquisition, the scope of the thesis does not allow for an examination of these aspects.

1.5 Concepts and Terms

A number of concepts and terms are applied in the thesis. In order to facilitate for the reader a definition will follow.

Mergers and acquisitions are given the same meaning for the sake of simplicity. The concept of concentration covers transactions in the form of mergers as well as acquisitions. In addition, the term concentration is given the same meaning as the term notified transaction, merged entity and new entity. The term undertaking refers to a company or a firm in general or to the parties of a concentration. The concept of market power includes both the ability to profitably reduce value for money, reduce choice, quality, variety and innovation to the detriment of the consumers as well as the ability of an undertaking to set prices above the competitive price level without losing sales to an extent that the price increase is unprofitable and must be rescinded. In addition, the term reduce value for money refers to the ability to increase price.

EC merger control proceedings available at www.europa.eu.int/comm/competition/mergers/legislation/consultation/best_practices.pdf.

[4] For a further explanation of the referral system; see the Commissions investigation of its function in the Green Paper, p. 7, pp. 20; see the ECMR2 Proposal regarding the main elements of the systems at paras 13-30 of the explanatory memorandum; and see the Commission Notice on Case Referral in respect of concentrations, OJ 2005 C56/03, for an elaborate explanation of the case referral systems, its guidelines and mechanics.

[5] As to the appraisal of the relevant product market, see Notice on the relevant market, paras 25-27, 36-43. As to ancillary restraints, see the Commission Notice on restrictions directly related and necessary to concentrations, OJ 2005 C56/03. As to the different measures used to calculate the market share and how the calculation of the market share is performed, see Notice on the relevant market, paras 53-55, Cook, p. 156, Lindsay, pp. 152. As to the failing firm defence, see paras 6, 96-98 of the Draft Notice, paras 89-91 of the Guidelines, Cook, p. 178, Navarro et al, pp. 153. As to remedies, see the Commission Notice on remedies acceptable under Council Regulation on the control of concentrations between undertakings, OJ 2001 C68/03

1.6 The Competition Policy

The aim of competition policy is to ensure that the market structure provides incentive for innovation and effective allocation of society's resources. This means that competition policy is a Community policy in its own rights as well as a vital dimension of several other policies such as the policy of the development of the internal market, the policy on growth and competitiveness, the policy of cohesion, the policy of research and development, the environmental policy and the consumer policy. Competition policy seeks, as an integral part of a number of Community policies, to achieve the Community objectives set out in Article 2 and 3 of the EC Treaty, where the promotion of market integration and effective, undistorted competition are central.[6]

1.6.1 Market Integration

Article 2 of the EC Treaty makes it clear that market integration is seen as an important goal of competition policy.[7] Market integration can be described as the "liberalisation of free movement of goods, persons, services and capital by the removal of internal frontiers resulting from differences in or systems of legislation and also by combating distortions of competition".[8] The establishment of a single market would deliver few economic advantages if undertakings were able to reintroduce trade barriers and frontiers. The competition policy is essential in ensuring that the benefits resulting from the opening-up of markets are not overturned by anti-competitive practices by undertakings.[9] In the Notice on the relevant market, special attention is given to the continuing market integration in the European Union. Para 32 of the Notice states that the measures adopted and implemented in the internal market programme to remove barriers to trade and further integrate the Community cannot be ignored when assessing the effects on competition of a concentration.[10] Article 2 of the Merger Regulation also clearly indicates that merger control is to be based on the principle of protecting free competition. The Merger Regulation contributes thus to the construction and completion of the internal market.[11] Overall, the competition policy is an essential means of ensuring that completion of the internal market brings the Community industry as a whole and consumers all the benefits that a Community-wide market derives.[12]

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[6] XXVIth Report, paras 1-2, XXIInd Report, paras 67, Bishop, pp. 1, Hildebrand, pp. 10, Steiner, p. 42. The Court of Justice have repeatedly in its decisions on competition issues made references to Article 2 and 3 of the EC Treaty as the basic principles underlying the rules of competition, Hildebrand, p. 2.

[7] Hildebrand, pp. 10, Steiner, pp. 42.

[8] Hildebrand, p. 10. Since the *Consten & Grundig* - case the European Court of Justice has made it clear that Community rules on competition also serve integration according to Hildebrand, p. 11.

[9] XXIVth Report, para 6 XXIIIrd Report, para 151, Bishop, pp. 3, Fejø, p. 31, Korah, p. 1.

[10] XXIVth Report, para 7.

[11] XXth Report, para 20.

[12] XXIIIrd Report, para 154.

1.6.2 The Maintenance of Effective Competition

The maintenance of effective competition is an economic goal and can be found in Article 3 of the EC Treaty. It is also an important goal of competition policy and the Merger Regulations allows the Commission to prohibit changes to the market structure that jeopardise the continuance of effective competition in the Common Market.[13] Thus, the following question arises: what constitutes a market structure of effective competition and what is the market performance under this structure? Few markets can be characterised as being perfectly competitive or as monopolies. However, an understanding of these market models illustrates the ways in which a lack of effective competition affects market performance. An analysis of these two models indicates that the fundamental difference between the market performances depends on whether the market structure allows market power to be possessed and exercised. Undertakings, which do not possess and exercise market power, are unable to effect competition adversely. A market structure of effective competition can therefore be defined as the absence of market power, the disability to raise prices above competitive price level and the disability to reduce product variety or innovation for a substantial period of time.[14] In conclusion, a market structure of effective competition is characterised by the lack of market power, but the question of what the characterising market performance of effective competition are remains. Market performances can be assessed regarding to the created total welfare, consumer welfare and efficiency gains. The EC Treaty as well as the Merger Regulation exemplifies the focus on consumer benefit. It reflects the basic idea that the consumer should benefit to a maximum, that they should receive a better offer, a better quality, more innovative products and services at lower prices.[15] The objective of the market performance of effective competition is to enhance efficiency, in the sense of achieving an optimal allocation of resources, which will maximise consumer welfare. In applying the Merger Regulation, it is clear that the Commission's focus is on the merger or acquisitions effect on consumer welfare. Through its control of mergers, the Commission prevents mergers that would be likely to deprive customers of these benefits by significantly increasing the market power of undertakings.[16]

[13] Article 2(1) a of the Merger Regulation explicit mentions the need to maintain and develop effective competition within the Common Market and Article 2(3) allows the Commission to prohibit concentrations which impedes effective competition.
[14] Bishop, p. 4, 11, Lindsay, p. 13.
[15] Bishop, p. 16, Hildebrand, p. 1. The Commissioner for Competition Policy, Mr Mario Monti, has said: "The goal of competition policy, in all its aspects, is to protect consumer welfare by maintaining a high degree of competition in the Common Market. Competition should lead to lower prices, a wider choice of goods, and technological innovation, all in the interest of the consumer", Speech of July 2001
[16] Bishop, pp. 3, Fejø, p. 28, Hildebrand, pp. 10, Lindsay, p. 48, XXIVth Report, para 3.

2 The Decision Making Frame of the Merger Regulation

2.1 Introduction

In order to decide whether a merger or acquisition falls within the scope of the Merger Regulation and thus under the jurisdiction of the Commission a two fold test is applied. First, there must be a concentration within the meaning of Article 3 and second,the concentration must have a Community dimension within the meaning of Article 1.

2.2 Definition of a Concentration

Recital 23 of the Merger Regulation describes concentrations as "operations bringing about a lasting change in the structure of the undertakings concerned." Article 3(1) provides that such a structural change is brought about either by a merger between two previously independent undertakings or by the acquisition of control over the whole or a part of another undertaking.[17]

Merger is not defined in the regulation but according to the Notice on the concept of concentration, a merger may occur either legally or by an economic concentration. The merger will occur legally when two or more independent undertakings amalgamate into a new undertaking and cease to exist as separate legal entities or when an undertaking is absorbed by another, the latter retaining its legal identity while the former ceases to exist as a legal entity.[18] The merger will occur by an economic concentration when previously independent undertakings combine their activities and contractually create a single economic management, an internal loss and profit compensation or a joint external liability, in which the undertakings retain their individual legal personalities.[19]

Acquisition of control is defined as an acquisition of rights, contracts or any other means, which separately or in combination confers the possibility of excercising decisive influence on an undertaking. The key issue is whether

[17] Notice on the concept of concentration, para 3.

[18] Notice on the concept of concentrations, para 6. The occurrence of a merger as described in the Notice is similar to the definition laid down in the Third Directive on Company Law. According to the Third Directive on Company Law a merger will occur where all the rights and liabilities of one or more companies are transferred to another company. The members of the acquired company or companies receive shares in the acquiring company. Following the transfer of assets and liabilities, the acquired company or companies cease to exist, Cook, p. 27.

[19] Notice on the concept of concentrations, para 7, XXIVth Report, para 139.

the rights acquired are sufficient for the acquiring undertaking to have a possibility to exercise decisive influence.[20]

2.3 Community Dimension

Concentrations have a Community dimension if: (a) the combined aggregate worldwide turnover of all the undertakings concerned is more than ECU 5000 million, where (b) at least two of the undertakings have a combined turnover of ECU 250 million in the EC but do not earn more than two-thirds of their turnover in a single Member State.[21] The worldwide turnover threshold is intended to measure the overall dimension of the undertakings concerned. The Community threshold seeks to determine whether the concentration involves a minimum level of activities in the Community and the two-third rule aims to exclude purely domestic transactions from the scope of the merger Regulation.[22]

Even if a concentration fails to meet the above turnover thresholds, it will fall within the scope of the Regulation if a second set of lower thresholds in Article 1(3) are met. The threshold is designed to include the concentrations that would need to be notified under national competition rules in at least three Member States. According to the second set of turnover thresholds concentrations will have a Community dimension if: (a) the combined aggregated worldwide turnover is more than ECU 2500 million, where (b) the combined aggregated turnover is more than ECU 100 million in each of at least three Member States, where (c) at least two of the undertakings have an aggregated turnover of ECU 25 million and (d) the aggregated Community-wide turnover of at least two of the undertakings is more than ECU 100 million in the EC but they do not earn more than two-thirds of their turnover in a single Member State.[23]

By determining the overall economic and financial resources that are being combined, Article 1 identifies those transactions which have an impact on the Community and can be deemed to be of Community interest. How to calculate the turnover is laid down in Article 5 and further explained in the Commissions Notice on undertakings concerned in order to ensure that the calculations are a true representation of economic reality.[24]

[20] Article 3(3), ECMR1, See also the Notice on the concept of concentration, paras 2-3.
[21] Article 1(2), ECMR1.
[22] Notice on calculation of turnover, para 3.
[23] Notice on calculation of turnover, para 3.
[24] Notice on calculation of turnover, para 6, 7.

3 Outline of The Appraisal of Concentrations

3.1 Introduction

The likely effect of notified concentrations is assessed against the economic goal of European competition policy: the maintenance of effective competition. The two-step approach first defines the scope of the relevant market. Factors for determination of the geographic market are discussed further in chapter 4. Second, the impact of the concentration of effective competition is appraised under the compatibility test discussed in chapter 5. The tow-step approach has been chosen as the structural frame for chapter 3, 4 and 5 due to the fact that the leading legal writers applies this structure when presenting the analytical approach used by the Commission in its appraisal of concentrations under the Merger Regulation.

3.2 The Relevant Market

The relevant market definition is a key concept in the application of the Regulation and a tool to identify and define the boundaries of competition between undertakings. The main purpose of the market definition is to identify relevant competitive forces the parties of the concentration faces that are capable of constraining the behaviour of the notified concentration and of preventing the notified concentration from behaving independently of effective competitive pressure. It is from this perspective that the market definition makes it possible to assess the market power of the concentration. The concept of the relevant market thus plays a central and often critical role in the application of the Regulation.[25] The definition of the relevant market involves the determination of both the product market[26] and the geographical market effected by the concentration.[27]

3.3 The Compatibility Test

When the scope of the relevant market has been defined, the Commission assesses whether a notified concentration is compatible with the Common Market. The competition assessment, also called the compatibility or the

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[25] Notice on the relevant market, paras 2, 4, Draft Notice, para 6, Bishop, pp. 46, Cook, pp. 134, Lindsay pp. 67, Hildebrand, p. 320.

[26] According to paragraph 7 of the Notice on the relevant market: " A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumers, by reason of the products' characteristics, their price and their intended use".

[27] Notice on relevant market, para 13.

substantive test, is laid down in Article 2(2), 2(3) of the Merger Regulation and involves two elements:

(i) An assessment of whether the concentration would lead to the ***creation or strengthening of a dominant position***
(ii) An assessment of whether the concentration would ***significantly impede effective competition in the Common Market or in a substantial part of it.***

The following subchapters will further examine the requisites dominant position, effective competition and significant impediment of the compatibility test.

3.3.1 Dominant position

The requisite dominant position has been identified by the European Court of Justice as "*a position of economic strength enjoyed by an undertaking which enables it to hinder the maintenance of effective competition on the relevant market by allowing it to act to an appreciable extent independently of its competitors and customers and ultimately of consumers*."[28] Dominance, a synonym for market power, arises when the concentration is able to profitably reduce value for money, choice or innovation. Dominance occurs not only where the competitive restraints on the notified concentration are absent but also where they are too weak in practice to affect its behaviour.[29]

3.3.2 Effective Competition

The compatibility test is based on the criterion of preserving and promoting an effective competitive structure in the Common Market from a consumer welfare perspective. In setting the Commission's objective as protecting effective competition, the fact that perfect competition rarely exists outside the economists' models is recognised.[30] Effective competition on the other hand exists in markets where competition constrains the undertakings from harming consumer welfare and describes the ability of markets to deliver products efficiently and at reasonable cost.[31]

3.3.3 Significant Impediment

A Significant Impediment describes the loss of a competitor/competitors which makes the market less perfect and involves a significant detriment to those who supply or buy in that market. The requisite "*significant*

[28] Cited in Lindsay, p. 29.
[29] Cook, p. 130, Lindsay, p. 145.
[30] Article 2(1) a of the Merger Regulation explicit mentions the need to maintain and develop effective competition within the Common Market.
[31] Cook, p. 151-152, Lindsay, p. 42-43.

impediment" has been defined by CFI as a substantial alteration of competition, which is so significant and lasting that the alteration impedes competition on the relevant market. Only a notified concentration resulting in such a significant impediment may be declared incompatible with the Common Market and prohibited.[32] The wording of a "substantial alteration" results in a de minimis defence; a notified concentration, which creates or strengthens a dominant position, will be cleared if its effect on the completive structure of the market is anything less than a substantial harm.[33]

[32] See Case No T-358/94 *Air France v Commission* OJ C 74/18 08.03.1997 and Case No T-102/96 *Gencor v Commission* OJ C 160/18 05.06.1999 referred to in Lindsay at p. 43, Jones, p. 166-167.
[33] Lindsay, p. 43-44, Jones, p. 167, Navarro et al, p. 142, Whish, p. 772.

4 The Appraisal of the Relevant Geographic Market

According to paragraph 8 of the Notice on the relevant market: "*The relevant geographical market comprises the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas, because, in particular, conditions of competition are appreciably different in those areas.*" [34]

When the Commission defines the relevant geographical market, they will first take a preliminary view on the distribution of market shares between the parties and their competitors as well as a preliminary analysis of pricing and price differences at national or Community level. This initial view provides for a prima facie indication regarding the geographical market and a working hypothesis in order to arrive at the precise geographic market definition.[35] For example, the presence of major suppliers in several Member States with significant market shares and little variation in price between the Member States indicate a wide geographic market. Conversely, national suppliers holding high market shares and appreciable differences on the market shares in the different Member States indicates a narrow geographic market.[36] When this preliminary view is established, the Commission will analyse the first sources of competitive restraint that undertakings are subject to; demand substitutability, because an undertaking cannot have a significant impact on the prevailing conditions of sale and prices if their customers are in a position to switch easily to available substitute suppliers located elsewhere. The second source of competitive restraint may, if found necessary, be analysed; supply-substitutability, which analyses the possibility of suppliers to switch production to the product the parties of the concentration produces.[37] The assessment of the geographical market is based on a combination of factors and when demand and, if necessary, supply substitutability is analysed the compatibility test is carried out.

4.1 Demand Side Substitution

One of the main sources of competitive restraint that undertakings are subject to is demand substitutability. The analysis of demand-side substitution is used to identify the boundaries of the competitive constraint imposed on the notified concentration and to determine the scope of the geographic market. The following subchapters will consider the most

[34] A similar wording is used in Article 9(7) ECMR1.
[35] Notice on relevant market, para 28.
[36] XXIInd report, para 241, XXIst Report, p. 361, Navarro et al, p. 124-125.
[37] Notice on relevant market, paras 13, 20,30.

important factors the Commission examines when analysing the demand side substitutability.

4.1.1 The SSNIP Test

The small but significant non-transitory increase in price test, also called the SSNIP test, is a helpful tool in order to identify areas in which substitute suppliers are located that the consumer can switch to in response to an increase in price.[38] The starting point is a narrow geographic market and the issue addressed is whether the customers of the parties to the notified concentration would switch to available suppliers located outside this geographic market in response to a hypothetical small permanent price increase, in the range of 5% to 10%. If the possibility to switch to other suppliers is enough, i.e. competition sufficiently constrains the pricing of the parties, to make the price increase unprofitable, due to loss of sales, additional areas with suppliers are included in the geographic market until a price increase of 5% to 10% would be profitable. The SSNIP test allows the Commission to identify a geographic area where the concentration would find it profitable to increase the price and thus the area within which the company will have sufficient market power to reduce value for money, variety or innovation significantly. This test provides useful evidence on the geographic market definition.[39]

4.1.2 Pricing

In order to identify areas within which customers can switch to a different supplier in response to an increase in price, the Commission will also analyse prices and trends in prices by applying different tests and studies. Price correlation studies and stationary tests analyses price movements in different geographic areas in order to reasonably conclude whether the areas form part of the same geographic market. The study of the uniformity of prices and price discrimination assess prices in different regions in order to find a strong indicator for the geographic market. However, it is difficult to obtain reliable data to base these studies and tests on. Nevertheless, the Commission regards a significant price difference or a difference in price trends between countries or regions as an indication that these countries or regions constitute separate geographic markets.[40] In the *Rhone-Poulenc/SNIA II* – case[41] the absence of price differences between countries was considered indicative of a market as wide as Western Europe. In the *Nestlé/Itagel* - case[42] price differences between countries were considered

[38] The test is also referred to as the "hypothetical monopolist test", Cook, p. 134, Hildebrand, p. 128.
[39] Notice on the Relevant Market, paras 15-17, Bishop, p. 53-54, Cook, p. 134-135, Hildebrand, p. 328-329, Lindsay, pp 73.
[40] Bishop, p. 66, Cook, p. 141-142, Hildebrand, p. 369, Jones, p. 127.
[41] Case No IV/M. 355 *Rhône Poulenc / SNIA (II)* OJ C 272/6 08.10.1993.
[42] Case No IV/M.362 *Nestlé/Itagel* OJ C 270/5 06.10.1993.

indicative of a predominantly national market.[43] In addition, the absence of parallel imports is considered a strong sign of a narrow geographic market while a high level of parallel import is considered a strong indicator of a wide geographic market.[44]

Price correlation studies identify statistically to what extent the prices over time are similar from one geographic region to another. The idea is that prices of a product that form part of the same geographic market are likely to move together.[45] The degree to which the price of a product in two regions moves together over time can be measured statistically by the correlation coefficient. The correlations coefficients range from zero, which indicates absence of correlation, to one, which indicates perfectly correlated price movements. The relevant question the study poses is whether the price in one region is constrained by the price in another region. A weak price correlation coefficient indicates separate geographic markets. However, the opposite is not necessarily true. A certain degree of price correlation cannot indicate the existence of a homogenous geographic market in the absence of other factors such as mutual interpenetration or similar structures of supply and demand in the different regions according to the Commission. [46]

The price correlation studies have become a standard tool of European competition law. The technique is exemplified in the *Lonhro/Genco*r – case[47], the *Mannesmann/Valourec/Ilva* – case[48], the *Nestlé/Perrier* – case[49] and the *Procter & Gamble/Schkiendanz* – case[50].[51] The price correlation analysis has, however, not had a decisive influence on the conclusion of the geographic market. This is due to the fact that the Commission‘s approach to price correlation studies is that they provide for an indication of the scope of the geographic area but not evidence. The Commission has regonised the weakness of the price correlation analysis that a high level of correlation between the prices can be caused by a number of factors and careful attention should be paid when selecting representative data when assessing price correlation. Despite the weaknesses of the price correlation analysis it is a useful tool for providing indications of the extent of the competitive relationship between different areas and thus the definition of the relevant geographic market.[52]

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[43] XXIIIrd Report, para 280, Hildebrand, p. 369.
[44] Navarro et al, p. 131-132.
[45] Bishop, p. 66, 169, Fishwick, p. 38, Hildebrand, p. 370, Lindsay, p.79, 124.
[46] XXIVth Report, para 29, Bishop, p.228-229. See also Case No IV/M.315 *Mannesmannn/Vallourec/Ilva* OJ L 102/15 21.04.1994 confirming this position, referred to in the XXIVth Report, paras 287, 291, 292.
[47] Case No IV/M.619 *Lonhro/Gencor* OJ L 011/30 14.01.1997.
[48] Case No IV/M.315 *Mannesmann/Valourec/Ilva* OJ L 102/15 21.04.1994.
[49] Case No IV/M.190 *Nestlé/Perrier* OJ L 356/01 05.12.1992.
[50] Case No IV/M.430 *Procter & Gamble/VP Schickedanz (II)* OJ L 354/32 31.12.1994.
[51] XXIVth Report, paras 287, 291, 292, Bishop, pp. 230, Cook, p. 142, Hildebrand, pp. 370.
[52] Bishop, p. 170-171, 225-226, 249, Cook, p. 142.

The analysis of ***uniformity in prices*** allows for a price study between different regions, which considers transport costs. The prices in two regions are compared after;

(i) Adjustments regarding transport costs and tariffs at a prevailing exchange rate. For example if product A is priced at 50 in region Y and 100 in region X and the transport costs from Y to X is 50, there may be competition in region X from undertakings in region Y.
(ii) Wholesale prices are generally compared net of all discounts and rebates.

In the *Nestlé/Ralston Purina* – case[53] the Commission recognised the importance of comparing prices adjusted to the transport costs. The Commission stated if transport costs did not account for the significant price differences this provides clear evidence on the capability of undertakings to apply different prices in different countries and thus for the scope of the geographic market. If prices are uniform between two areas, this is consistent with the areas forming part of the same geographic market. However, although a strong indicator, it is not decisive since the price can be uniform by coincidence. Conversely, if the prices are not uniform it is not decisive but a strong indicator that the areas form separate geographic markets.[54]

Price discrimination is defined as charging different prices net of transport costs for the same product to different buyers in different areas when the price is not related to differences in costs and/or prevents resale between those buyers. Where price discrimination is possible, these areas may comprise separate geographic markets as the parties of the notified concentration could profitably impose a small but significant and non-transitory increase in price.[55]

4.1.3 Basic Demand Characteristics

Customer preferences are another important factor to examine when establishing the scope of the geographic market. Customer preferences that vary from Member State to Member State or region to region is a factor that supports a national or regional geographic definition. Customer preferences include preferences of national brands[56], language and culture[57] and may appear from survey evidence. [58] In the *Nestlé/Perrier* – case[59] different

[53] Case No IV/M.2337 *Nestlé/Ralston Purina* OJ L 239/8 25.08.2001.
[54] Fishwick, pp. 31, Hildebrand, p. 117, Lindsay, p. 125-126.
[55] Hildebrand, p. 365, Lindsay, p. 126-127.
[56] In Case No IV/M.2817 *Barilla/BPL/Kamps* OJ L 198/04 21.08.2002 the Commission stated that brand reputation must be built up on a country-by-country basis according to Lindsay, p. 135.
[57] In Case No IV/M.423 *Newspaper Publishing* OJ C 085 22.03.1994 the geographic market for newspapers were found to be national because of linguistic and cultural specificities according to XXIVth Report, para 28.
[58] Notice on relevant market, para 46, Cook, p. 144, Navarro et al, pp. 125.

consumer preferences for bottled water between Member States was among the factors determining the geographic market to France. In the *Allied Lyons/HWE-Pedro Domecq* – case[60] and the *BSN/EURALIM* – case[61] the markets for alcoholic spirits and ready-prepared meals were found to be essentially national because of the existence of national brands corresponding to national consumer preferences.[62]

4.1.4 Switching Costs

Switching costs are obstacles that make it difficult for consumers to switch to other suppliers and obstacles that make it difficult for undertakings in one area to satisfy demands in another area. Switching costs such as transport costs and legislation have to be identified and analysed and may be a decisive factor deciding whether a market has a Community, regional, national or local dimension.[63]

Transport costs can provide indirect evidence of the relevant geographic market. Where transport cost are high relative to the price of the product it soon becomes uneconomical and uncompetitive to transport the products to distant customers. Thus, transport costs that are high relative to the price of the product suggests that the geographic market is relatively small but it is not decisive. In the *Fletcher Challence/Methanex* – case[64], the *Kimberly-Clark/Scott* - case[65] and the *KNP/BT/VRG* – case[66], significant transport costs were considered as a factor likely to constrain the scope of the geographic market. The impact of transport costs will usually limit the scope of the geographic market for high volume low-value products.[67] In the *Steetley/Tarmac* - case[68] a local geographic market for bricks was established, since bricks are both heavy and bulky and transport represents a significant percentage of total selling prices. In the *Nestlé/Perrier* – case[69] the fact that bottled water is a low value high volume product that cannot bear transport costs over long distances was among the factors limiting the geographic market to France.[70] Conversely, transport costs that are low relative to the price of the product indicate that the geographic market is relatively wide. In the *Pilkington-Techint/SIV* – case[71] the geographic market of flat glass was held to be EC-wide since transport costs were found to be relatively low in relation to the price of the products. Hence, an

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[59] Case No IV/M.190 *Nestlé/Perrier* OJ L 356/01 05.12.1992.
[60] Case No IV/M.400 *Allied Lyons/HWE-Pedro Domecq* OJ C 126 07.05.1994.
[61] Case No IV/M.455 *BSN/EURALIM*OJ C 269 27.09.1994.
[62] XXIIIrd Report, para 281,XXIInd Report, para 240, XXIVth Report, para 288.
[63] Notice on the relevant market, para 50, Navarro et al, p. 129.
[64] Case No IV/M.331 *Fletcher Challence/Methanex* OJ C 098 07.04.1993.
[65] Case No IV/M.623 *Kimberly- Clark/Scott* OJ L 183/001 23.07.1996.
[66] Case No IV/M. 291 *KNP/BT/VRG* OJ L 217/35 27.08.1993.
[67] Notice on relevant market, para 50.
[68] Case No IV/M.180 *Steetley / Tarmac* OJ C 050 25.02.1992.
[69] Case No IV/M.190 *Nestlé/Perrier* OJ L 356/01 05.12.1992.
[70] XXIInd Report, paras 239, 240.
[71] Case No IV/M.358 *Pilkington-Techint/SIV* OJ L 158/24 25.06.1994.

important factor to assess is how far the product can be transported before it becomes uneconomical.

On the other hand, there is no hard rule for determining at what point transport costs relative to selling price becomes an influential factor in assessing the geographic market.[72] Nevertheless, where transport costs are less than five per cent of the selling price they are unlikely to play an influential part in determining the geographic market.[73] In the *Solvay/Montedison-Ausimont* - case[74] transport costs were significant and accounted for up to 10 per cent of the selling price. However, the Commission found that the geographic market was EEA-wide due to the absence of trade barriers between Member States, the existence of common European standards and rules, and the fact that supply and demand were organised on a pan-European basis. [75] Similarly, in the *DuPont/ICI* – case[76] high transport costs had little impact on the assessment of the geographic market. In this case, because all producers were located in the same part of the EC, they were therefore equally effected by transport costs when competing for customers.[77] These cases demonstrate that transport costs are not decisive for defining a geographic market and that consideration of other factors is necessary as they may make it feasible for undertakings to supply a region in despite of high transport costs.[78]

Legal restrictions such as quotas, tariffs, regulatory barriers and technical standards have to be analysed to establish the scope of the geographic market. The existence of an EC external tariff was taken into account to indicate a Community-wide market in the *Fletcher Challenge/Methanex* – case.[79] In the *Electrolux/AEG* - case[80] the existence of European standards for electrical equipment was taken to indicate a geographic market of Western Europe for domestic appliances. In the *Price Waterhouse/Coopers & Lybrand* – case[81] the existence of national regulatory requirements for statutory audits and professional qualifications was taken into account when determining the geographic market as national. [82]

Other switching costs such as ***support services*** also have to be assessed in order to define the geographic market. Customers requiring after-sale services provided through a local presence suggest a relatively small geographic market. In the *Metso/Svedala* – case[83] the geographic market for

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[72] XXIIIrd Report, para 284, Cook, p. 145, Hildebrand, p. 364.
[73] Bishop, p. 68, Cook, p. 144-145, Lindsay, pp. 129.
[74] Case No IV/M.2690 *Solvay/Montedison-Ausimont* OJ L 153/11 27.06.2002.
[75] Lindsay, p. 130-131.
[76] Case No IV/M.984 *DuPont/ICI* OJ C 004/4 08.01.1998.
[77] Cook, p. 144-145.
[78] Bishop, p. 262.
[79] Case No IV/M.331 *Fletcher Challence/Methanex* OJ C 098 07.04.1993.
[80] Case No IV/M.458 *Electrolux/AEG* OJ C 187 09.07.1994.
[81] Case No IV/M.1016 *Price Waterhouse/Coopers & Lybrand* OJ L 050/27 26.02.1999.
[82] XXIIIrd Report, para 283, XXIVth Report, para 289, Notice on relevant market, para 50, Fishwick, p. 26-27, Lindsay, p .132, Navarro et al, p. 131.
[83] Case No IV/M.2033 *Metso/Svedala* OJ L 088/01 25.03.2004.

rock crushing equipment was found national because the customers depended on the producers' distributors or agents for virtually all specialised key services or parts. Similar in the *Johnson & Johnson/Depuy* – case[84] the geographical market for reconstructive implants for hips and knees was appraised as national because the customers required training and assistance at a local presence.[85]

4.1.5 Current Geographic Pattern of Purchase

An examination of the customers' current geographic pattern of purchases provides useful evidence as to the possible scope of the geographic market and the boundaries of the competitive constraint imposed on the notified concentration and is used to decide the true importance of the identified switching costs.[86] Where are the suppliers located? Are the goods delivered to the customers or do the customers visit the suppliers? If the customers visit the supplier, the geographic market depends on the customers' willingness to travel. If the suppler delivers the goods to the consumers the importance of just-in time delivery and the cost of delivery is important to assess.[87] An indication of an EC-wide market is a product supply from one region in Europe throughout the Community. In the *Electrolux/AEG* – case[88] a western European market for domestic appliances was found to exist in light of the fact that major manufacturers had established centralised, large-volume assembly-line plants, from which products were transported throughout Europe.[89]An indication of a local geographical market is the product being produced and supplied locally. The Commission has in a number of cases decided in favour of a national or local market on the basis that distribution channels are organised within that area or due to the just in time servicing and supplying.[90] When customers purchase from companies located anywhere in the EU or the EEA on similar terms, or they obtain their supplies through tendering procedures in which companies from anywhere in the EU or EEA submit offers, the geographic market will usually be considered to be Community-wide.[91]

4.1.6 Trade Flows

Information on trade flows might be used alternatively when it is not possible to establish a clear picture of geographic purchasing patterns. For

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[84] Case No IV/M.1286 *Johnson & Johnson/Depuy* OJ C 294/03 23.09.1998.
[85] Lindsay, p. 132.
[86] Notice on the relevant market, para 48, Navarro et al, p. 132.
[87] Lindsay, p. 127, Navarro et al, p. 128-129.
[88] Case No IV/M.458 *Electrolux/AEG* OJ C 187 09.07.1994.
[89] XXIVth Report, para 289.
[90] Cook, p. 143, Lindsay, p. 135.
[91] Hildebrand, p. 387. See for example Case No IV/M. 355 *Rhône Poulenc / SNIA (II)* OJ C 272/6 08.10.1993 where the Community-wide purchasing policy of the concentrations consumers determined the definition of the geographic market as Community-wide according to Navarro et al, p. 128.

example, when the number of customers is too large, if the trade statistics are available with a sufficient degree of detail information of trade flows may be used. An analysis of trade flows provides useful insights for the purpose of establishing the scope of the geographical market but it is not, alone,conclusive. When assessing the trade between two areas, the level of import and export is a factor as well as the mutual interpenetration, i.e. two-way trade, between the areas.

In general, the Commission considers that import levels less than five-ten per cent of the consumption in the relevant area indicates that this area constitutes a separate market. However, the level of increase of imports and the possible future projection of increase of imports might lead to a wider market definition.[92] In some cases the import level of ten-fifteen per cent has been held to suggest wider markets, because such levels of imports indicate that the switching costs of the area may be overcome. Nevertheless, the import levels have to be analysed to establish whether they reflect true competitive constraints posed by other undertakings or whether the import levels are the effect of cross-border trade caused by the location of factories close to borders or due to intercompany transactions.[93]

Regarding the analysis of export, the Commission takes the position that the fact that the product in question is exported from the given area does not mean that the geographic market should include the areas of exports.[94]

The Commission also analyses the mutual interpenetration between two geographic areas. The existence of imports and exports between two areas is consistent with those areas that form the same geographic market. Conversely, the absence of trade between two areas is consistent with the fact that the two areas form separate geographic market and that switching costs are present.[95] Absence of or limited mutual interpenetration is often used by the Commission to support the conclusion that separate geographical markets exist.[96] In the *AKZO/Nobel Industries* – case[97] the absence of two-way trade flows was taken to indicate a Western European market for chemical intermediate products since significant exports from Western Europe were not matched by significant imports. However, the presence of significant trade flows was considered to indicate at least

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[92] Notice on the relevant market, para 49, Navarro et al, p. 132-133.

[93] See Case No IV/M.2337 *Nestlé/Ralston Purina* OJ L 239/8 25.08. referred to in Navarro et al, p. 133.

[94] See Case No IV/M.190 *Nestlé/Perrier* OJ L 356/01 05.12. and Case No IV/M.315 *Mannesmann/Valourec/Ilva* OJ L 102/15 21.04.1994 referred to in Navarro et al, p. 134.

[95] XXIVth Report, para 287, Bishop, p. 250-251, Hildebrand, p. 371, Navarro et al, p. 135.

[96] There exist two tests based on trade flows to determine the geographic market; the Elzinga-Hogarty test and the Shrieves test. However, the reliability of the Elzinga-Hogarty test has been questioned by the Commission and the Schrieves test has never been used in European competition law according to the XXIVth Report, para 292, Bishop, pp. 251.

[97] Case No IV/M.390 *AKZO/Nobel Industries* OJ C 019 21.01.1994.

Community-wide market in the *Rhone Poulenc/SNIA II* – case[98] and in the *Fletcher Challenge/Methanex* – case[99].[100]

4.2 Supply Side Substitution

Another main source of competitive restraint that undertakings are subject to is supply-side substitution. The analysis of supply-side substitution is used to identify the boundaries of the competitive constraint imposed on the notified concentration. Supply side substitution involves identifying suppliers already present on the market or new entrants, which would switch their line of production and offer the relevant products. In order to measure the supply-side substitutability the Commission applies the SSNIP-test and poses the question: are there suppliers that are able to switch production to the relevant product and market them within a short term without incurring significant additional costs or risk in response to a small and permanent changes in relative price? If the answer is yes, these suppliers are able to compete with the concentration and should be included in the geographical market. Supply-side substitutability will be further discussed in chapter 5.2 and 5.3 as it is in the appraisal of the competitive constraint posed by actual and potential competitors that the supply-side substitution is the most apparent.[101]

4.3 Concluding Remarks

The definition of the geographic market is a tool that enables the Commission to build a framework for determining the likely market power of a concentration. The geographic market definition is thus a key step in the appraisal of concentrations under the Merger Regulation and crucial for determining a concentrations compatibility with the Common Market. The reason is as follows: markets that are defined narrowly will typically lead to a high degree of market power. Thus, the widest possible market definition is desirable from the concerned parties' point of view. In order to be able to argue for a wide geographic definition it is necessary to analyse the factors affecting the definition of the relevant geographical market and examine what factors that make the Commission decide upon a narrow or a wide market definition. The Commission has, in its appraisal of the geographic market in notified concentrations, found local, national, regional, and community markets as well as world markets. The most important factors, how they can be analysed with the aid of economic tools and their possible indication regarding the determination of the scope of the geographic market, have been identified in the previous chapters. Infra follows an overview of the findings in the format of a table.

[98] Case No IV/M. 355 *Rhône Poulenc / SNIA (II)* OJ C 272/6 08.10.1993.
[99] Case No IV/M.331 *Fletcher Challence/Methanex* OJ C 098 07.04.1993.
[100] XXIIIrd Report, para 282, XXIVth Report, para 287, Hildebrand, p. 371.
[101] Notice on relevant market, paras 20-23, Eklöf, p. 279, Hildebrand, p. 328, 373.

Factors	*Indication of a wide geographic market*	*Indication of a narrow geographic market*
Presence of major suppliers in several Member States with significant market shares	Yes	No
National suppliers with significant market shares and appreciable differences in the distribution of market shares in the different Member States	No	Yes
A weak price correlation coefficient	No	Yes
A strong price correlation coefficient	Yes	No
Uniformity in prices	Yes	No
Differences in prices	No	Yes
Possibility to discriminate regarding price	No	Yes
Consumers have strong preference for national brands	No	Yes
Language and cultural barriers	No	Yes
Transport costs are high relative to the price of the product	No	Yes
Transport costs are low relative to the price of the product	Yes	No
Import quotas	No	Yes
Import tariffs	No	Yes
National regulatory barriers	No	Yes
Technical standards	No	Yes
Customers require after-sales services through local presence	No	Yes
Customers willing to travel to the supplier	Yes	No
Just-in-time deliveries of importance	No	Yes
The products are supplied throughout the Community	Yes	No
The products are supplied locally	No	Yes
Local distribution system	No	Yes
Similar distribution system throughout Europe	Yes	No
Consumers have a European purchasing policy	Yes	No
High levels of import	Yes	No
Significant degree of mutual market interpenetration	Yes	No
Low degree of mutual market interpenetration	No	Yes

However, the individual factors do not constitute decisive evidence as to the scope of the market, only an indication. It is not until all of the relevant factors are taken into account that the definition of the geographic market can be determined. Therefore, the combination of factors characterised for a community wide market, a wide market and a narrow geographic market definition will be considered infra.

(i) Factors in support of a Community wide geographic market
The existence of Community wide markets has been established in several decisions. These markets were normally characterised by a combination of the following factors;

- The presence of major suppliers in several Member States, with significant market shares according to the preliminary view
- Uniformity in price between Member States
- Relatively low transport costs
- A high level of the products are supplied throughout the Community
- The consumers have European-wide purchasing polices
- Significant degree of mutual market interpenetration
- Relatively low trade levels between the Community and the rest the world, and the existence of an EC external tariff[102]

(ii) Factors in support of a wider geographic market
The existence of a wide geographic market is often indicated by the combination of the following factors;

- Presence of major suppliers in all Member States according to the preliminary view
- Uniformity in prices
- Lack of strong preferences for national brands
- Low transport costs
- Absence of import tariffs, quotas, national regulatory barriers, technical standards and language and cultural barriers enabling quick and easy transfer of supply
- Similar distribution systems throughout Europe
- The consumers have International/European buying policies
- Substantial mutual market interpenetration[103]

(iii) Factor in support of a narrow (national) geographic market
The existence of a narrow geographic market is often indicated by the combination of the following factors;

- National suppliers holding high market shares and appreciable differences in market shares in the various territories considered according to the preliminary view
- Differences in prices
- Importance of national brands
- Existence of language and cultural barriers
- Just-in-time deliveries of importance
- High transport costs or difficult transport

[102] XXIInd Report, para 241. See also Case No IV/M.166 *Torras/Sarrio* OJ C 058 05.03.1992, Case No IV/M.160 *Elf Atochem/Rohm & Haas* OJ C 201 08.08.1992, Case No IV/M.198 *Péchiney/Viag* OJ C 307 25.11.1992, Case No IV/M.152 *Volvo/Atlas* OJ C 017 23.01.1992, Case No IV/M.256 *Linde/Fiat* OJ C 258 07.10.1992, Case No IV/M.253 *BTR/Pirelli* OJ C 265 14.10.1992, Case No IV/M.1882 *Pirelli/BICC* OJ L 070/35 14.13.2003, Case No IV/M.706 *GEC Alsthom/AEG* OJ C 308/04 17.10.1996 and Case No IV/M.984 *DuPont/ICI* OJ C 004/4 08.01.1998 for examples of a community-wide defined geographic market referred to in XXIInd Report, para 241, XXVIth Report, pp. 174.
[103] XXIst Report, p. 360, Hildebrand, p. 383-384.

- Import tariffs
- Legal and technical restrictions
- Different distribution channels and marketing methods in the Member States
- Need to establish a distribution infrastructure and a reputation
- Low degree of mutual market interpenetration[104]

[104] XXIst Report, p. 361, Hildebrand, p. 382-383.

5 The Compatibility Assessment

The Commission assesses the unilateral effects, also called non-coordinated effects, which might arise from the concentration. Unilateral effects arise when the merged group is able to profitably reduce value for money, choice or innovation through its own acts. The Commission has to establish a causal link between the creation or strengthening of a dominant position (market power) and a significant detrimental impact on effective competition (unilateral effects).[105] The question of causation is analysed by identifying:

(i) The pre-merger or pre-acquisition state of the market structure; in other words, how much competition is there on the market?
(ii) The likely post-merger or post-acquisition state of the market structure; in other words, how much competitive restraint is left over?
(iii) The differences between steps (a) and (b), i.e. the effects of the notified transaction; in other words, how much competitive constraint has been lost?[106]

The Commission thus has to analyse the likely future market power of the new entity and its effect on the structure of competition on the relevant market concerned applying a consumer welfare criterion. This requires a structural and prospective comprehensive economic analysis based on a number of factors the Commission finds relevant. The most significant factors, which have influenced the Commission's judgement, are:[107]

(i) The market shares of the parties of the concentration on the relevant market;
(ii) The market shares of the remaining competitors, the level of concentration on the relevant market and the competitive constraint posed by actual competitors;
(iii) The competitive constraints posed by potential competitors including the likelihood of new entrants and barriers to entry;

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[105] Bishop, p. 143, Cook, p. 128, Lindsay, p. 59, 145, Whish, p. 773.
[106] Lindsay, p. 45-46, 61, Draft Notice, para 10, Guidelines, para 9.
[107] Article 2(1) of the Merger Regulation lists economic factors the Commission takes into account when judging dominance. Article 2(1) includes; the structure of all the markets concerned, the actual or potential competition from undertakings, the market position of the undertakings concerned and their economic and financial power, suppliers and users access to supplies and markets, barriers to entry, the interest of the consumers, and the development of technical and economical progress provided that it is to consumers' advantage and does not form an obstacle to competition. Article 2(1) is not an exhaustive list, or a ranking of the factors listed and the Commission is free to analyse all factors they find relevant according to Cook, p. 150, Korah, p. 310., Whish, p. 773.

(iv) The competitive constraints posed by customers[108]

When the Commission carries out this prospective comprehensive economic analysis based on the factors above, the Commission has developed a general practice of focusing on the development of the market, over two to three years following the decision. In the *Procter & Gamble/VP Schikedanz (II)* – case[109] the Commission examined the possible development of the market within the near future, i.e. three years, and stated that events outside this period fell outside the relevant perspective under the Merger Regulation. [110]

The following subchapters consider the above-described significant factors, which have influenced the Commission's judgement as to whether a particular concentration does in fact create or strengthen a dominant position capable of damaging effective competition.

5.1 Market Shares

The definition of the relevant market allows for the identification of the suppliers active on that market and the calculation of the market shares.[111] When assessing a concentration's compatibility with the Common Market the market share provides a useful staring point.[112] In general, the larger the post-merger or post-acquisition market share of the notified concentration, the more likely it is that the concentration will be held to create or strengthen a dominant position. The reason is that a large market share is associated with market power, which refers to the ability to, profitably; reduce value for money (i.e. raise price), choice or innovation.

However, the market shares do not *per se* reflect the actual degree of market power enjoyed by a concentration. There is no simple relationship between the market share and the degree of the effective competition in a market and therefore, the calculated market shares have to be used with caution and only serve as an indication of the competitive constraints posed on a notified concentration.[113] This is confirmed and further explained by the Commission in the Tenth Competition Policy Report, where the Commission held that a dominant position could generally be said to exist

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[108] Draft Notice, paras 20,23,24, Guidelines, para 11, XXIst Report, pp. 362, XXIInd Report, paras 246, 250, Bos et al, p. 213, Cook, pp. 152, Lindsay, pp. 188.
[109] Case No IV/M.430 *Procter & Gamble/VP Schickedanz (II)* OJ L 354/32 31.12.1994.
[110] Lindsay, p. 62. See also Case No IV/M.1693*Alcoa/Reynolds* OJ L 58/25 28.02.2002, Case No IV/M.1806 *AstraZeneca/Novartis* OJ C 102/30 28.04.2004, Case No IV/M.1846 *Glaxo Wellcome/SmithKline Beecham* OJ C 170/06 20.06.2000 and Case NO IV/M.56 *Hutchinson/RCPM/ECT* OJ C 113/07 14.05.2002 confirming the time period of three years referred to in Lindsay at p. 62-63.
[111] Notice on the relevant market, para 53.
[112] Draft Notice, para 14, Guidelines, para 14, Jones, p. 132-133.
[113] Bishop, p. 146, Cook, p. 151, Hildebrand, p. 323, 358, Lindsay, p. 175.

once a market share in the order of 40-45 per cent is reached.[114] The Commission further explained that this share however, does not in itself automatically give control of the market. Unless there are large gaps between the position of the firm concerned and those of its closest competitors, or other factors such as the accumulation of the leading brands on the market there may be no control of the market by the concentration. The question of dominance ultimately stands and falls with the change in strength of the concentration in relation to remaining competitors including whether the parties of the concentration have been rivals and imposed an important competitive constraint on each other. If the notified concentration can act without regard to its competitors, actual or potential, or its customers, the resulting market structure will distort the maintenance of effective competition.[115] According to the Commissions statement the emphasis is laid on (i) whether the merging parties are close competitors and (ii) the position of remaining competitors and on the entry conditions for potential competitors, rather than on the actual market shares of the concentration.

(i) The parties of the concentration are close competitors

The elimination of rivalry between the parties of the concentration may eliminate an important competitive constraint and thus strengthen the market power of the concentration. In addition, the higher the degree of substitutability between the merging parties products, the more likely it is that the new entity will exercise its market power and increase price significantly, reduce choice or innovation post-merger. The market share-analysis can therefore be misleading if the merging firms produce differentiated products, products that are not regarded by customers as close substitutes. If so, a high market share may not be indicative of market power. [116] In order to decipher if the products supplied by the parties to the concentration are substitutable or differentiated, market surveys provide valuable sources of information and may be used to assess customers' preferences for particular characteristics in products.[117]

In the *DuPont/ICI* – case[118], the Commission concluded that the concentration eliminated the main source of competition and that the concentration would no longer face any significant competitor. The Commission also found that the degree of substitutability between the parties' products determined the likelihood of post-merger price increases

[114] The Commission has suggested that a dominant position cannot be ruled out even if an undertaking has a market share between 20 to 40 per cent. For example in Case No IV/M.862 *AXA/UAP* OJ C 38/06 07.02.1997 the Commission carefully reviewed whether a market share of 30 per cent could lead to dominance, Hildebrand, p. 355.

[115] Xth Report, para 150. See also Cook, p. 152, Draft Notice, para 23, Lindsay, p. 200.

[116] Baker, pp. 412, Lindsay, pp. 182, Navarro et al, pp. 158, Völcker II, p. 398, Draft Notice, paras 34-38, Guidelines, para 28.

[117] Survey evidence was used to modify the market share analysis in Case No IV/M.430 *Procter & Gamble/VP Schickedanz (II)* OJ L 354/32 31.12.1994 and Case No IV/M.623 *Kimberly- Clark/Scott* OJ L 183/001 23.07, referred to in Baker, p. 415, Lindsay, p. 185, Guidelines, para 29. See also Baker, pp. 417, Lindsay, p. 186, Völker II, p. 400-401.

[118] Case No IV/M.984 *DuPont/ICI* OJ C 004/4 08.01.1998.

but they did not conduct a customer survey in this respect. In the *Barilla/BPL/Kamps* - case[119] the Commission also found that the concentration eliminated the main source of competition and that the concentration would no longer face any significant competitor. However, regarding the substitutability of the merging parties' products, the Commission conducted a customer survey, establishing that the products were one another's closest substitutes.[120] The Commission has thus in conclusion taken into account the closeness of the merging parties' products or the elimination of rivalry between them as a factor in the analysis of the creation or strengthening of a dominant position.-

(ii) The position of the remaining competitors and the entry conditions
Nevertheless, the position of remaining competitors and the entry conditions of potential competition must be assessed in order to determine the real market power of an concentration with a high market share. A fact confirmed by the Commission in the *Tetra Pak/Alfa Laval* –case[121]: "*a market share as high as 90 per cent is, in itself, a very strong indicator of the existence of a dominant position. However, in certain rare circumstances even such high market share may not necessarily result in dominance. In particular if sufficient active competitors are present on the market, the company with large market shares may be prevented from acting to an appreciable extent independently of the pressure typical of a competitive market*."[122]

In conclusion, high market shares can be an indication of the existence of a dominant position. However, such indicators may be countered by other factors; such as the parties to the concentration producing differentiated products, sufficiently strong active competitors present on the relevant market, strong buying power of customers and the high probability of strong market entry. Thus, it is of importance to assess the market shares in the context of the nature of competition on the market and although the level of the market share of the notified concentration is a significant, it is not determinative in the dominance assessment.[123]

Furthermore, it is also of importance to assess the market shares, not only in the light of the nature of competition on the market but also in the context of the markets characteristics. The significance of high market shares also varies with the stage of development, growth, innovation and technological

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[119] Case No IV/M.2817 *Barilla/BPL/Kamps* OJ L 198/04 21.08.2002.
[120] Völker II, p. 398. The Commission also considered issues of product differentiation in for example Case No IV/M.2544 *Masterfood/Royal Canin* OJ L 79/10 03.04.2002 and in Case No IV/M.1980-3 *Volvo/Renault VI* OJ C 301/23 21.10.2000 referred to in Lindsay, p. 187-188, Baler, pp. 417.
[121] Case No IV/M.068 *Tetra Pak/Alfa Laval* 290/35 22.10.1991.
[122] Cited in Cook, p. 154-155.
[123] XXIst report, p. 363, Hildebrand, p. 391-392. According to the XXIInd Report, para 247 the highest market share accepted for clearance in 1992 amounted to 48 per cent in the whole of the Community and 79, 5 per cent in one Member State. The lowest market share, giving raise to a creation of dominance, was 43 per cent in the EEC and 53 per cent in one Member State.

change on the market concerned. In the *Digital/Philips* - case[124] the Commission stated that high market shares on high-growth markets involving modern technology do not necessarily indicate market power.In addition,) the *Digital/Kienzle* - case[125] found that high market shares were not extraordinary on a new developing market. [126]

In evaluating the significance of market shares, the Commission also examines the past and the likely future evolution of market shares.[127] The strength of the concentration differs according to whether the market share of the parties is increasing, stable or declining.[128] Steadily decreasing market shares are a strong indicator of effective competition resulting from, for example, the market entry of competitors. Conversely, steadily increasing market shares are a strong indicator of a decrease of effective competition. A stable high market share over several years suggests that the parties enjoy market power.[129] Nevertheless, the past market shares may not be a reliable guide to the future. Despite this fact, the Commission stated in the *Mannesmann/Hoesch*[130] – case that: "*If no other structural factors are identified which are liable in due course to change the existing conditions of competition, market shares have to be viewed as a reliable indicator of future conditions*."[131] Future changes in the structure of the market shares must be reasonably certain to occur and in a relatively short timescale.[132]

5.2 Actual Competitors

As stated above it is rare that competitive concerns arise from the aggregated market share of the notified concentration alone. The emphasis in appraising the creation or strengthening of a dominant position is not to be found in the market shares of the concentration but on the concentration of the market and on the position of remaining competitors. The Commission appraises whether other remaining competitors could exercise a restraint on a, by a market share definition, dominant concentration by investigating: (i) the divergence of market shares between the concentration and its competitors; (ii) concentration data; and (iii) whether the competitors constitute alternative sources of supply.

(i) ***The divergence of market shares between the concentration and its competitors***
A small number of competitors with broadly equivalent positions on the market may be sufficient to maintain effective competition. Where there is considerable divergence between the shares of the concentration and its

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[124] Case No IV/M.129 *Digital/Philips* OJ C 235 10.09.1991.
[125] Case No IV/M.0057 *Digital/Kienzle* OJ C 056 05.03.1991.
[126] XXIst Report, p. 363, Jones, p. 134, Navarro et al, p. 151.
[127] Bos et al, p. 356, Jones, p. 134, Draft Notice para 14-15, Guidelines, para 15.
[128] XXIInd Report, para 249, XXIst Report, p. 363, Bos et al, p. 356.
[129] Hildebrand, p. 392-393, Lindsay, p. 178, Navarro et al, p. 151.
[130] Case No IV/M.222 *Mannesmann/Hoesch* OJ L 114/34 08.05.1993.
[131] Cook, p 153-154.
[132] Cook, p 154.

competitors the Commission may regard the competitor's presence on the market as insufficient to counteract the dominance of the concentration.[133] In the *Metso/Svedala* – case[134], the gap between the market share of the concentration and those of its leading competitors was decisive for the dominance assessment. The Commission stated that the competitors would not be able to sufficiently constrain the dominant position of the concentration.[135]

(ii) ***Concentration data***

The ability to exercise market power is associated with the level of concentration on the relevant market. The overall concentration on a market provides useful information about the competitive situation on the market between the concentration and its competitors, before and after the transaction. Therefore, the overall concentration is a useful supplement to the analysis of the divergence of market shares.[136] The most commonly employed means[137] to measure the concentration is with the Herfindahl-Hirshmann index. The HHI measures the size of all the companies on the relevant market as well as capturing the dispersion of the market shares. The HHI is calculated by summing the squares of the individual market shares of all the firms on the market.[138] The HHI ranges from close to zero to 10 000, in the case of pure monopoly. The HHI increases as the number of undertakings falls and the variance of the market shares increases. The HHI gives an indication of the competitive pressure and the change in the concentration of the market post-transaction.[139]

(iii) ***Whether the competitors constitute alternative sources of supply***

In order to assess whether the remaining competitors are able to counteract the dominance of the concentration the Commission will examine whether they provide alternative sources of supply for customers. If they do, the concentration will be unable to increase prices, as customers will switch to other suppliers. In order for actual competitors to be an alternative source of supply and act as an countervailing power they must either have spare capacity or be readily able to expand by adding new capacity.[140] In the *Friesland Coberco/Nutricia* – case[141], the Commission found that the competitor's available spare capacity would considerably constraint the concentrations possibility to exercise its market power and raise prices.[142]

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[133] Cook, p. 156-157, Jones, p. 138-139, Navarro et al, p. 159-160.
[134] Case No IV/M.2033 *Metso/Svedala* OJ L 088/01 25.03.2004.
[135] Referred to in Lindsay, p. 214.
[136] Draft Notice, para 16, Guidelines, para 16, Hinten-Reed, p. 158, Report on Unilateral Effects, p. 59-60, Lindsay, p. 215.
[137] The Commission also employ the concentration ratio measuring the total share held by the four largest companies. The ratio have a significant limitation, it does not measure the distribution of the market shares amongst the companies according to Lindsay, p 215-216
[138] For example, a market containing five firms with market shares of 40, 20,15,15 and 10 percent respectively has an HHI of 2250 ($40^2 + 20^2 + 15^2 + 15^2 + 10^2$), See Draft Notice, para 16, Guidelines, para 16, Report on Unilateral Effects, p. 60, Lindsay, p. 216.
[139] Lindsay, p. 216-217, Draft Notice, para 16, Guidelines, para 1.9
[140] Jones, p. 139-140, Lindsay, p. 218, Navarro et al, p 161.
[141] Case No IV/M.2399 *Friesland Coberco/Nutricia* OJ L 018/14 22.01.2002.
[142] Lindsay, p. 219.

In order to determine whether competitors are readily able to expand they must have the financial resources necessary and the expansion has to be likely, timely and sufficient in order for the competitors to act as a countervailing power. A competitor with low market shares might be an effective constraint if the competitor is committed to expand and has access to the financial resources needed as in the *Alcatel/Telettra* - case[143].[144] When the Commission has established that competitors have actual capacity to expand or potential to rapidly expand their capacity, the Commission assesses whether these competitors are likely to be able to win new business from the concentration, should the concentration decide to exercise its market power. A factor reducing the competitor's ability to win over business is the customers do not regarding them as credible alternatives to the concentration. This occurs for example, when the competitors' products are regarded as inferior or second-rate, when the competitor has access to a distribution network or when delivery is unreliable. Other factors reducing the competitor's ability to win over business are inferior production facilities, production facilities operating at relatively higher costs or the lack of economies of scale, which are available to the concentration. In some cases, the Commission has distinguished between first-tier, second-tier and local competitors to emphasis their respective ability to win over new business.[145]

If actual competition is found to be a sufficient competitive constraint to deter the concentration from exercising its market power and increase price, the Commission is unlikely to find that the concentration will create or strengthen a dominant position.[146]

5.3 Potential Competition and Barriers to Entry

The consideration of potential competition is necessary if the actual competitors are deemed insufficient to deter the notified concentration from exercising its market power.[147] A potential competitor is the undertaking:

(a) Producing the same products but operating in a different area, which may be able to start supply the relevant geographic market in response to an increase in price by the concentration.

(b) Producing related products, and have the ability to switch product lines to produce the relevant product in response to an increase in price by the concentration.[148] For example, in the *Tetra Pak/Alfa Laval* – case[149]

[143] Case No IV/M.042 *Alcatel/Telettra* OJ L 122/48 17.05.1991.
[144] XXIst Report, p. 264, Cook, pp. 156, Lindsay, pp. 219, See also the Guidelines, para 34.
[145] Lindsay, pp. 220, Navarro et al, pp. 163.
[146] Notice on the relevant market, para 13, Bishop, p. 155, Guidelines, para 33.
[147] Bishop, p. 155.
[148] Fishwick, p. 56-57, Hildebrand, p. 375, Jones, p. 143, Navarro et al, p. 258-259.

there were undertakings producing machines that required only little modification to be used in the milk industry. In the *Rhône-Poulenc/SNIA(II)* – case[150], undertakings producing carpet fibres were able to change production to textile and industrial fibres within less than one day at a very low cost.[151]

Regarding the analysis of the likely competitive impact of potential competition the Commission poses the question: is there sufficient potential competition on the market to constrain the concentration's exercise of market power? In order to answer the question the Commission examines whether entry by potential competitors is probable, whether it would be competitively meaningful and effective, and whether it could take place within a time frame short enough to deter the parties from exploiting their market power.[152] Thus, the criterion to assess is; (i) the likelihood of entry; (ii) the timeliness of entry; and (iii) whether entry is sufficient in magnitude and scope to constrain the concentration from exercising its market power.

(i) ***The likelihood of entry;***
The likelihood of entry depends on whether an entry will be profitable or not. If the concentration exercises its market power and increases price a hit-and-run entry will occur due to the profit opportunity and the fact that entry as well as exit, if the profit opportunity disappears, are possible with no or very low sunk costs. Sunk costs are costs that are posed upon entry and irrecoverable upon exit from the market. When entry involves sunk costs, barriers to entry arise. However, hit-and-run entry is rarely observed and most undertakings upon entry incurs significant sunk costs attracting only long-term entry by potential competitors. Long-term entry will only occur due to an increased price if the post-entry competition on the market would result in prices and revenues that cover the cost of entry. [153] The profitability prediction by a long-term-entrant depends on the prediction of costs, the post-entry market price, the likely sales and the likely evolution of the market. Regarding the evolution of the market, long-term entry is more likely to occur in a growing market, rather than in a declining or static market.[154]

In conclusion, the likelihood of entry depends on the barriers to entry. The entry barriers can be classified into two main types; (a) absolute advantages enjoyed by the concentration over a potential entrant; and (b) strategic advantages enjoyed by the concentration.[155]

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[149] Case No IV/M.068 *Tetra Pak/Alfa Laval* 290/35 22.10.1991.
[150] Case No IV/M. 355 *Rhône Poulenc / SNIA (II)* OJ C 272/6 08.10.1993.
[151] XXIst Report, p. 366, XXIInd Report, para 253.
[152] XXIVth Report, para 311, Draft Notice, para 79, Guidelines, para 68, See also Case No IV/M.190 Nestlé/Perrier OJ L 356/01 05.12.1992 cited in Lindsay, p. 231.
[153] Bishop, pp. 155, Fishwick, .p 58, Lindsay, p. 241.
[154] Lindsay, pp. 232, Navarro et al, pp. 248, Draft Notice, para 83, Guidelines, paras 69,72.
[155] Bishop, pp. 301, Lindsay, pp. 239,Draft notice, para 81, Guidelines, paras 71, 36.

(a) Entry barriers in form of absolute advantages arise when the concentration has access to resources that are not available for the potential entrant, for example;

- *Legal restriction* on entry such as license requirements, safety standards, tariffs[156], quality certification[157] and technical requirements;
- *Technical advantages,* such as access to essential facilities, natural resources, exclusive intellectual property rights[158] and research and development;
- *Economies of scale and scope*. By producing at a certain level, that an entrant might not be able to enter at, the concentration has lower unit costs than the entrant does. This poses)a cost disadvantage and may also render entry unprofitable.[159]
- *Promotion or advertising*. If entrants have to invest in promotion or advertising of a new brand due to consumer loyalty to leading or already existing brands this will pose a cost advantage, which might render the entry unprofitable.[160]
- *The investment needed to enter the market.* The Commission has identified the investment needed as a barrier to entry, especially when the market is mature, as exemplified in the *NewHolland* – case[161].[162]

(b) Entry barriers in form of strategic advantages are derived from the concentration already established on the market. Strategic entry barriers are for example the experience, goodwill, reputation, brand loyalty[163], investment in excess capacity and an established distribution and sales

[156] Absolute advantages in the form of tariffs have been identified by the Commission in Case No IV/M.315 *Mannesmann/Valourec/Ilva* OJ L 102/15 21.04.1994 referred to in Cook, p. 159.
[157] In Case No IV/M.315 *Mannesmann/Valourec/Ilva* OJ L 102/15 21.04.1994 the Commission found that East European producers, who have modern production facilities would be able to rapidly obtain the appropriate quality certification to supply Western European customers and thus serve as an additional constraining factor against anti-competitive behaviour, XXIVth Report, para 312, and pp. 457, Hildebrand, p. 408.
[158] Absolute advantages in the form of patents have been identified by the Commission in Case No IV/M.068 *Tetra Pak/Alfa Laval* 290/35 22.10.1991 referred to in Cook, p. 159.
[159] Bishop, p. 302, Cook, p. 159, Navarro et al, p. 244-245, Lindsay, p. 241-242. See also Case No IV/M.2033 *Metso/Svedala* OJ L 088/01 25.03.2004 where economies of scale were identified as a barrier to entry, the Commission stated that the economies of scale would place an entrant at a cost-disadvantage in relation to well-established producers, referred to in Lindsay, p. 242. See also the Case No IV/M.774 *Saint Gobain/Wacker-Chemie/NOM* OJ L 247/01 10.09.1997 referred to in Cook , p. 159.
[160] Absolute advantages in the form of advertising has been identified by the Commission in Case No IV/M.623 *Kimberly- Clark/Scott* OJ L 183/001 23.07.1996, Case No IV/M.190 *Nestlé/Perrier* OJ L 356/01 05.12.1992 and in Case No IV/M.430 *Procter & Gamble/VP Schickedanz (II)* OJ L 354/32 31.12.1994, Lindsay, p. 244, Navarro et al, p. 248.
[161] Case No IV/M.1571 *NewHolland* OJ C 130/11 11.05.2000.
[162] See also Case No IV/M.068 *Tetra Pak/Alfa Laval* 290/35 22.10.1991 and Case No IV/M.774 *Saint Gobain/Wacker-Chemie/NOM* OJ L 247/01 10.09.1997 referred to in Navarro et al, p. 245.
[163] The Commission has identified the strength of established brands as an absolute advantage in Case No IV/M.938 *Guinness/Grand Metropolitan* OJ L 288/24 27.10.1998 referred to in Cook, p. 185.

network[164] enjoyed by the concentration. The concentration may also react aggressively towards the new entrant by for example, cutting prices and increasing advertising in order to increase demand for its own products at the expense of the products of the potential entrant. In sum, it is the complete uncertainty that reduces the attractiveness and the profitability of entry.[165]

It is a difficult task to assess the barriers of entry. However, the history of previous actual, attempted and threatened entry and exit to the market in question is an important indication. If entry to the market has taken place, this suggests that entry barriers are low and that it is reasonable that future entry will be successful. Conversely, the fact that new entry has not occurred in the past suggests that entry barriers are high. Similarly, if previous attempts to enter the market have been unsuccessful, they appear to be unsuccessful in the future.[166] When entry barriers are low, the concentration will be more likely to be constrained by new entry. Conversely, when entry barriers are high, the concentration can be expected to exert their market power and raise the price without being constrained by new entry.[167] It is not alone enough to argue that barriers to entry are high or low. What matters is whether the entry of potential competitors is sufficient in magnitude and scope to deter the concentration from exercising its market power and whether the entry of potential competition will be sufficiently quick and persistent to prevent the exercise of market power.[168]

(ii) ***The timeliness of entry***

The timeliness of entry depends on the period likely to be needed for a potential competitor to overcome entry barriers, establish a presence on the market, and prevent the exercise of market power by the concentration, thus preserving and developing effective competition within the meaning of Article 2(3) of the Merger Regulation. The period of time within which entry and the prevention of market power exercise must be likely to occur is generally within two to three years.[169]

(iii) ***Whether entry is sufficient in magnitude and scope to constrain the concentration from exercising its market power***

The likely and timely entry must also be sufficient in magnitude and scope to counteract the concentrations market power. An entry will be sufficient in magnitude and scope if it eliminates the anti-competitive effects of the

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[164] The need to provide a distribution and sales network constituted a barrier to entry in Case No IV/M.623 *Kimberly- Clark/Scott* OJ L 183/001 23.07.1996 referred to in Lindsay, p. 246 and in Case No IV/M.430 *Procter & Gamble/VP Schickedanz (II)* OJ L 354/32 31.12 referred to in the XXIVth Report, para 313. The need to establish handling facilities constituted a barrier to entry in Case No IV/M.1157 *Skanska/Scancem* OJ L 183/01 16.07.1999 referred to in Cook, p. 185.

[165] Bishop, p. 302-303, Cook, p. 159.

[166] Jones, pp. 147, Lindsay, pp. 234, Draft Notice, paras 80,85, Guidelines, para 70

[167] Draft Notice, para 80, Guidelines, para 80.

[168] Bishop, p. 156 -157, Draft Notice, para 86,Guidelines, para 68.

[169] XXIst Report, p. 365, Draft Notice, para 86, Guidelines, para 74, Cook, p. 156-157, Jones, p. 125, Lindsay, p. 235-236.

concentration by depriving the company holding a high market share of the ability to act to an appreciable extent independently of market pressure. The threat of entry must be enough to deter the concentration from increasing prices.[170]

In conclusion, if it is established that new entry would be likely, timely and sufficient to defeat any attempt by the concentration to exercise its market power, i.e. increase price or reduce quality, variety or innovation, a concentration holding a high market share is likely to be found compatible with the Common Market. [171]

5.4 Buyer Power

The competitive constraint of countervailing buyer power is regularly considered by the Commission but has been an influential factor in only a few cases. The Commission summarised the relevance of buyer power in the *Coca-Cola/Carlsberg* - case[172]: "*in an assessment of dominance the question is whether there is sufficient countervailing buyer power to neutralise the market power of the parties*."[173] The countervailing buyer power depends on the symmetry between the buyers and the concentration; whether the buyers are able and have incentive to switch to alternative sources of supply in response to a change in price; and what negotiating power the buyers can exercise over the concentration, due to the buyers' size and commercial significance to the concentration. It is not sufficient that buyer power exists prior to the concentration, it must also exist and remain effective post-concentration. [174]

The Commission investigated the symmetry between the buyers and the concentration in the *Coca-Cola/Carlsberg* - case[175] and the *Skanska/Scancem* – case[176], where the Commission noted that the buyers were more dependent on the concentration than the concentration on the buyers.[177] Conversely, in the *Alcatel/Telettra* – case[178], the very strong market position of the concentration was countered by the buying power of a large purchaser, Telefonica, capable in the near future of increasing its

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[170] XXIst Report, para 365, Draft Notice, para 86,Guidelines, para 68, Lindsay, p. 237.
[171] XXIst Report, p. 362, 365, Draft Notice, para 79, Guidelines, para 68, Lindsay, p. 146, 231, 237. This position was confirmed in Case No IV/M.053 *Aerospatiale-Alenia/De Havilland* OJ L 334/42 05.12.1991, see also Case No IV/M.042 *Alcatel/Telettra* OJ L 122/48 17.05.1991 and Case No IV/M.068 *Tetra Pak/Alfa Laval* 290/35 22.10.1991 referred to in the XXIst Report, p. 365, Case No IV/M.190 *Nestlé/Perrier* OJ L 356/01 05.12.1992 referred to in Hildebrand, p. 412 and Case No IV/M.222 *Mannesmann/Hoesch* OJ L 114/34 08.05.1993 referred to in Lindsay, p. 238 and the XXIVth Report, para 312.
[172] Case No IV/M.833 *Coca-Cola Company/Carlsberg AS* OJ L 145/41 15.05.1998.
[173] Cited in Cook, p. 161.
[174] Bishop, pp. 161, Lindsay, pp. 251, Navarro et al, pp. 183, Draft Notice, paras 75-77, Guidelines, paras 64,66.
[175] Case No IV/M.833 *Coca-Cola Company/Carlsberg AS* OJ L 145/41 15.05.1998.
[176] Case No IV/M.1157 *Skanska/Scancem* OJ L 183/01 16.07.1999.
[177] Lindsay, p. 254.
[178] Case No IV/M.042 *Alcatel/Telettra* OJ L 122/48 17.05.1991.

purchases from other suppliers. Telefonica was thus not dependent on *Alcatel/Telettra* and could bring pressure on the new entity.[179] Similarly, in the *Enso/Stora* – case[180] one customer accounted for a substantial share (50 per cent of the concentrations output in the whole EEA) of the purchasing and two other main buyers had already made strategic imports from the US. The Commission found that these circumstances produced a mutual dependence between buyers and sellers and that the powerful customers could effectively neutralise the dominant position of the merged entity and the concentration creating a market share of 50-70 per cent was cleared.[181] Conversely, in the *Hoffmann-La Roche/Boehringer Mannheim* – case[182], there was no substantial countervailing buyer power to balance the market power of the notified concentration because the largest customers of the parties did not account for a substantial part of either party's sales.[183]

Buyer power in the form of negotiation advantages arises when the customers are able to delay purchases, award contracts through tendering, enter into short-term contracts with suppliers or threat to switch suppliers.[184] However, the negotiation power in form of the threat to switch suppliers may not be viable if the concentration produce products with certain technical specifications or when the concentration possesses the leading or most recognised brands.[185]

When assessing the countervailing buyer power the Commission considers the buyer power of all customers and not only the large ones, examining the welfare of each buyer separately. In the *Nestlé/Perrier* – case[186] the Commission stated that they have to protect the weaker buyers. Even if some buyers have buyer power, in the absence of sufficient competitive pressure on the market, it cannot be ignored that the concentration will be able to apply different conditions of sales on different customers. Thus, buyer power is of little relevance when the concentration is able to price discriminate.[187]

In addition, the fact that buyer power exists is in itself rarely sufficient to neutralise the market power of a concentration with very high market shares as seen in the *Solvay/Montedison-Ausimont* – case[188]. The reason is that the buyers cannot generally defeat the concentration's ability to exercise its market power in such cases, in contrast to the ability of actual and potential competitors. In cases where the notified concentration has a significant market share, the buyer power tends to be relevant only in consideration

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[179] XXIst Report, p. 364.
[180] Case No IV/M.1225 *Enso/Stora* OJ L 254/09 29.09.1999.
[181] XXVIIIth Report, para 159, Bernitz, p. 25, Lindsay, p. 255.
[182] Case No IV/M.950 *Hoffmann-La Roche/Boehringer Mannheim* OJ L 234/14 21.08.1998.
[183] XXVIIIth Report, p. 191-192.
[184] Lindsay, p. 251-252.
[185] Navarro et al, pp. 183.
[186] Case No IV/M.190 *Nestlé/Perrier* OJ L 356/01 05.12.1992.
[187] Referred to in Lindsay, p. 255, Draft Notice, para 77,Guidelines, para 67.
[188] Case No IV/M.2690 *Solvay/Montedison-Ausimont* OJ l 153/11 27.06.2002.

with other factors, which together serve as competitive constraint on the concentration.[189]

5.5 Countervailing Benefits

One of the criteria for assessing concentrations is the "*development of* ***technical and economical progress*** *provided that it* ***is to consumers' advantage*** *and* ***does not form an obstacle to competition***" according to Article 2(1)b of the Merger Regulation. However, the role of efficiencies created by a merger or acquisition has been widely debated. The question is whether efficiencies should be included in the wording of "*technical and economical progress*" and if so, to what extent the efficiencies generated by the concentration can counterbalance the market power gained, and thus be used to justify mergers. These are the mergers which otherwise are found to create or strengthen a dominant position.[190] The standpoint adopted by the Commission is that concentrations are judged based on their anti-competitive effects alone, and that there is no explicit provision for an efficiency defence under the Merger Regulation that can be used to justify mergers, which would otherwise be unacceptable. The Commission has, in a number of cases rejected arguments that efficiency gains should be treated positively.[191] For example in the *Lonhro/Gencor* – case[192] where the Commission found that the concentration would increase the market power and if there were any efficiencies they would not benefit the consumers because the concentration would form an obstacle to competition.[193]

5.6 Concluding Remarks

When the scope of the geographic market has been determined, the Commission is able to appraise a concentration's compatibility with the Common Market. In order to assess a concentration's effect on the market structure the pre-transaction and post-transaction structure of the market is analysed. From an economic viewpoint, there are a number of factors to measure the effect of a merger on market conditions and thus, it is of importance to examine the factors' influence on the compatibility assessment.

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[189] Lindsay, p. 251.
[190] Bishop, p. 161, Korah 2001, p. 610, Lindsay, p. 425.
[191] Study on the Efficiency Defence, p. 1,7, Cook, p. 178, Bishop, p. 161, Knable, pp. 218, Korah 2001, p. 610-611, Whish, p. 779, Lindsay, p. 431.
[192] Case No IV/M.619 *Lonhro/Gencor* OJ L 011/30 14.01.1997.
[193] Referred to in Lindsay, p. 431. See also Case No IV/M.774 *Saint Gobain/Wacker-Chemie/NOM* OJ L 247/01 10.09.1997 referred to in Lindsay, p. 431, Case No IV/M.053 *Aerospatiale-Alenia/De Havilland* OJ L 334/42 05.12.1991, Case No IV/M.126 *Accor/Wagons-Lits* OJ L 204/01 21.07.1992, Case No IV/M.469 *MSG/Media Service* OJ L 364/01 31.12.1994, Case No IV/M.353 *British Telecom/MCI* OJ C 253 23.09.1993 and Case No IV/M.315 *Mannesmann/Valourec/Ilva* OJ L 102/15 21.04.1994 referred to in Korah 2001, p. 611

The Commission applies a traditional competitive assessment, which can be divided into 4 phases with the following factors as indicators of dominance:

Phase 1 - The position of the parties to the concentration pre- and post transaction

- The concentration acquires a high market share, generally above 40 per cent
- The aggregate market share of the parties is substantially increased
- The parties of the concentration are close competitors
- The products the parties of the concentration produce are regarded as close substitutes according to customer survey evidence
- The market is stagnated
- The parties market shares has in the past steadily increased
- The parties market share has in the past been stable and high
- The parties of the concentration are in possession of the leading brands

Phase 2 - The position of actual competitors, they are not able to constrain the concentration from exercising its market power

- There is a high divergence in the market shares between the concentration and its competitors
- There is a high HHI
- No viable alternative sources of supply because;
  - The competitors have no spare capacity or are not ready to expand capacity due to high sunk costs or insufficient financial resources.
  - The competitors have spare capacity or are ready to expand but are not likely to win over new business because the products are second-hand or inferior, the competitor has no access to a distribution network or because the competitor has higher cost of production.
  - The competitors have spare capacity or are ready to expand and are likely to win over business but the expansion will not be timely or sufficient to constraint the concentration from exercising its market power

Phase 3 - The position of potential competition, they are not able to constrain the concentration from exercising its market power

- Potential competitors are unlikely to enter the market due to high barriers to entry inducing high sunk costs rendering entry unprofitable
- There is no evidence of past entry to the market
- Potential competitors are likely to enter the market but the entry will not be timely, i.e. occur within two or three years
- Potential competitors are likely to timely enter the market but will not be able to constrain the concentration from acting to an appreciable extent independent of market pressure

Phase 4 - The position of the buyers, they are not able to neutralise the concentrations market power

- The buyers have no incentive to switch to alternative suppliers
- The buyers have no negotiating power; they are not able to delay purchases, threat to switch supplier due to the technical specifications of the products produced by the concentration or due to the brands the concentration owns, award contracts through tendering or enter into short-term contracts.
- The buyers are more dependent on the concentration than the concentration on the buyers; the largest buyers do not account for a substantial part of the concentrations sales.
- The concentration is able to discriminate buyers regarding price, charging different buyers different prices

The supra identified factors enable the concentration to act without regard to its competitors, actual or potential, or its customers resulting in a market structure that will distort effective competition.

6 Case Study

6.1 Introduction

The reason for selecting the *SCA/Metsä Tissue* - case and the *Volvo/Scania* - case is they illustrate how the relevant geographic market can be determined as national in scope and how a concentration can be found to create or strengthen a single firm dominance in the Nordic countries, enabling the concentration to increase customer price. The purpose of the case study is to illustrate the application of the factors examined in the previous chapters and the Commissions' appraisal of concentrations under the Merger Regulation.

The Commission prohibited the acquisition of Finnish tissue paper manufacturer Metsä Tissue by its Swedish competitor SCA Mölnlycke in 2001. The Commissions investigation showed that where the transaction to proceed it would have created or strengthened a dominant position for 26 hygiene tissue products, such as toilet roll and kitchen towels, in the national markets of Sweden, Norway, Denmark and Finland and severely limited consumers choice and enabled the concentration to raise customer prices.

The Commission prohibited the acquisition of the Swedish truck manufacturer Scania by it Swedish competitor Volvo in 2000. The Commission investigation showed that the transactions would have created or strengthened a dominant position regarding heavy trucks, city buses, inter-city buses and touring coaches in the national markets of Sweden, Norway, Finland, United Kingdom and Ireland and would therefore have significantly changed the market structure to the detriment of the customers

6.2 The Appraisal of the Geographic Market in the SCA/MetsäTissue-Case

This chapter will examine the determination of the scope of the geographic market for branded labelled products[194]. However, the examined appraisal closely follows that of the private labelled products[195] and away from home products[196]. The Commission concluded that the relevant geographic market

[194] Branded labelled products consists of the tissue products manufactured under the undertakings own brand.
[195] Private labelled products consists of the tissue products manufactures under the customers own brand.
[196] Away from home products consists of the tissue products manufactured sold to whole-salers who in turn supply smaller servicing companies that deliver the tissue product as part of a service package to the final (institutional) customer.

for branded consumer products in the Nordic countries was national based on the following considerations:

The preliminary view of market shares pointed towards national manufacturers holding high market shares and showed considerable differences in the distribution of the market shares from Member State to Member State, indicating that the Nordic countries constituted separate geographic markets.[197]

The Commission concluded that as the products are delivered to customers' warehouses, it is possible for a manufacturer controlling all supplies to one or more of the Nordic countries to increase price on customers in one country without affecting prices in another country. In addition, high transport costs in addition to customers' need of regular just-in-time deliveries would render arbitrage impossible. The possibility of future price discrimination was taken to suggest national geographic markets.[198]

The Commission considered whether customer preferences existed for national brands. Survey evidence showed that spontaneous awareness of one of SCA´s brands varied substantially between different Nordic countries, supporting the theory that markets for branded consumer goods were national even when the same brand is used in different countries. [199]

The Commission further found switching costs in the form of transport costs to be high in relation to the value of the products constituting a significant obstacle to supplying the products over large distances. SCA argued that the economies of scale outweighed the transport costs incurred in distributing products to any location in Europe. However, the Commissions market investigation found a maximum distance of approximately 800 to 1000 km due to the importance for customers of reliable just-in-time deliveries. An exception however was found with Italian manufacturers supplying distances up to 2000 km. The Commission, in response to the exception, emphasised that the most successful Italian producers recently established or will establish production facilities in France to serve Northern Europe customers. Hence, the proximity to markets seems to be a competitive factor the Italian manufacturers take into account once they have established a foothold in an export market.[200]

The market investigation conducted by the Commission showed that buyers in the Nordic countries generally organise their purchases on a national basis confirming the identified switching costs. In addition, the market investigation showed that buying products through cross-border purchasing groups is not very developed. The geographic patterns of purchasing behaviour suggested a national market.[201]

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[197] The *SCA/MetsäTissue* – case, para 39, 56. See chapter 4.3.
[198] Ibid. paras 47,48, 51. See chapter 4.1.2.
[199] Ibid. paras 54, 55. See chapter 4.1.3.
[200] Ibid. paras 36, 43-46. See chapter 4.1.4.
[201] Ibid paras 49, 50, 52. See chapter 4.1.5.

6.3 The Compatibility Assessment in the SCA/MetsäTissue – Case

This chapter will examine the compatibility assessment of branded labelled products and the finding of a created or strengthened dominant position, which would significantly impede effective competition in the Swedish market. However, the examined appraisal closely parallels that of the other Nordic national markets.

The Commission assessed the current structure of the Swedish market for branded consumer products.

Market shares	SCA	MT	SCA/MT	Munksjö	Fort James
Toilet Tissue	20-30 %	60-70 %	80-90%	20 %	<5 %
Kitchen Towels	30-40 %	50-60 %	80-90 %	15 %	<5 %

The market share calculation showed that the combined market share of SCA and Metsä Tissue were four times higher than that of the next competitor. The concentration would thus increase the gap between the market share held by the concentration and that of its closest competitor.[202] The Commission appraised whether SCA and Metsä Tissue were close competitors as well as the degree of substitutability between the merging par ties products. According to a costumer survey, the parties' brands were generally considered as the strongest and the most well known brands in Sweden. The Commission concluded that SCA and Metsä Tissue were close competitors and that the concentration would eliminate the main source of competition on the basis that the concentrations would combine the four leading brands on the market.[203]

When assessing the competitive constraint posed by actual competitors(,) the Commission appraised whether the remaining competitors constituted viable alternate sources of supply. The Commission distinguished between first tier, second tier and local competitors to emphasise their respective competitive significance and their ability to win over business if the concentration would exercise its market power and increase price. Munksjö was appraised as a local competitor and Fort James as a second tier competitor, suggesting that the remaining competitors would not pose sufficient competitive constraints on the concentration.[204]

The Commission concluded that few if any potential competitors producing related products were likely to switch production and build a new brand due to the prohibitive costs involved. The Commission also appraised whether potential competitors producing the same product but operating in a different area would be likely to enter the market by establishing new

[202] Ibid. paras 80-81. See chapter 5.1.
[203] Ibid. paras 82-83,94. See chapter 5.1.
[204] Ibid. paras 38, 83. See chapter 5.2.

production capacity in Sweden. However, few if any, potential competitors were found likely to enter the market due to the significant costs, estimated at EUR 80 to 125 millions. Furthermore, if a potential competitor were to enter the market it would take several years before the entrant could exert an effective competitive restraint on the concentration. New entry in the form of delivery from existing plants outside Sweden was found unlikely, due to the combination of high transportation costs and high costs of entering a mature and stagnating market with strong established brands which would render such entry unprofitable. The high barriers to entry were also evidenced by Fort James, which has production facilities in Finland but has only achieved a very moderate market share in Sweden.[205]

The Commission concluded that the countervailing buyer power was not sufficient to pose a competitive constraint on the concentration because;

- Even if the three largest buyers account for 85 per cent of the parties' sales, buyer power can only be exercised effectively if the buyer has an adequate choice of alternate suppliers. In the Commissions view, no comparable brands were available and thus there can be no mutual dependency.
- It is easy to price discriminate between different customers as the products are delivered to the customers. Customers will also not be able to counter price discrimination through arbitrage, since the products have high transportation costs relative to total costs and the need for just-in-time delivery, often several times per week.
- Even if the largest customers would be able to exercise some countervailing buyer power this would not protect smaller customers.[206]

6.4 The Appraisal of the Geographic Market in the Volvo/Scania - Case

This chapter will examine the determination of the scope of the geographic market for heavy trucks. However, the examined appraisal closely follows that of the city buses, inter-city buses and touring coaches. Volvo argued that the relevant geographic market was at least EEA-wide. The Commission, however, counterbalanced the arguments and determined the scope of the geographic market was national as following;

(i) Volvo argued that the major suppliers were active EEA-wide and that the seven largest suppliers were present in almost all Member States. The Commissions preliminary view regarding the distribution of the market shares, however, pointed towards national suppliers holding high market shares and appreciable differences in markets shares from Member State to Member State indicating national markets.[207]

(i) Volvo argued that the prices were uniform in the EEA. Based on

[205] Ibid. paras 57, 92-93. See chapter 5.3.
[206] Ibid. paras 85, 88-91. See chapter 5.4.
[207] The *Volvo/Scania* - case. paras 34, 65. See chapter 4.

price lists, the Commission established that Volvo had applied significantly different prices between neighbouring countries. The Commission also established that price discrimination between the different Member States had taken place. These facts suggested that the conditions of competition differed from Member State to Member State and that the market was national.[208]

(ii) Volvo argued that technical switching costs were absent due to product standardisation, which resulted in the fact that the same basic truck could be sold and used throughout Europe. The Commission established that the basic demand characteristics regarding the customer requirements of models and technical configurations of heavy trucks presented considerable variations from Member States to Member State, providing an indication of national markets. The Commission also established that switching costs existed in the form of legal restrictions, for example different regulations regarding tonnage and maximum length of the trucks and the Swedish authorities' requirement of the cab crash test indicating national markets.[209]

(iii) Volvo argued that switching costs in the form of the need to establish dealer and after sales networks were absent. The Commission however established that the choice of a certain brand of heavy trucks by a customer depended on the extent of after-sales assistance, maintenance services, second-hand value etc provided by the manufacturer at a local basis therefore showing that switching costs in the form of after sale service network existed, pointing towards a national market. [210]

(iv) Volvo argued that large, private, trans-border purchasers, who had knowledge of prices and competitive conditions in other Member States as well as dual sourcing were emerging, indicating an EEA-wide market. The Commission's investigation of the geographic purchasing patterns found that purchasing was done on a national basis due to the difference of customer preferences, technical requirements, price and the need for dealer support in form of after sales service.[211]

(v) Volvo argued that there was a high level of mutual market interpenetration and substantial exports to support an EEA-wide market definition. The Commission however did not counterbalance this argument because the trade flow analysis is applied when it is difficult to establish a clear picture of geographic purchasing patterns. [212]

6.5 The Compatility Assessment in the Volvo/Scania – Case

This chapter will examine the compatibility assessment and the finding of a created or strengthened dominant position, which would significantly impede effective competition in the Swedish market. However, the appraisal

[208] Ibid. paras 34, 38-49, 91-93. See chapter 4.1.2.
[209] Ibid. paras 34, 50-57. See chapter 4.1.3, 4.1.4.
[210] Ibid. paras 34, 61-64. See chapter 4.1.4.
[211] Ibid. paras 34, 58-61. See chapter 4.1.5.
[212] Ibid. paras 33, See chapter 4.1.6.

regarding the other national markets closely follows that of the Swedish market.

The Commission assessed the current structure of the Swedish market for heavy trucks where Volvo had 44.7 per cent, Scania 46.1 per cent DaimlerChrysler 6.2 per cent and the other competitors less than one per cent of the market. The market share calculation showed that Volvo and Scania's market shares were seven times higher than that of the next competitor and would have combined share of 90.8 per cent. The Concentrations would thus increase the gap between the market share held by the concentration and that of its closest competitor.[213] The Commission appraised whether Volvo and Scania were close competitors as well as the degree of substitutability between the merging parties products on the basis that both brands are generally perceived as the expression of quality products and that the examination of Volvo's and Scania´s respective market share clearly showed their essentially parallel positions in the different markets. In addition, the examination of the market share in the Nordic countries over a long period showed that the market share gains by one undertaking appeared to correspond with losses by the other. These facts suggested that Volvo and Scania were close competitors and each other's closest substitutes.[214]

Regarding the past and likely future evolution of the market shares, the Commission found that the shares of the parties to the concentration had been relatively stable over a very long period suggesting that the parties to the concentration enjoyed market power. Regarding the future evolution of the market share Volvo presented studies indicating a large market share loss as an immediate effect of the merger. The studies however, had weaknesses and the Commission therefore disregarded them.[215]

The Commission found that there was virtually no actual competitor to Volvo and Scania, with the exception of DaimlerChrysler. Volvo argued that DaimlerChrysler was readably able to expand their supply of heavy trucks on the Swedish market and to adapt their after-sales service network for heavy trucks. However, the Commission found that such expansion would not be likely due to the deterring sunk costs of at least EUR 2 500 000 compared with the size of the market and the concentrations post-merger position on the market.[216]

The Commission concluded that few if any potential competitors would be likely to enter the market due to substantial barriers to entry in the form of the need and difficulties to establish a geographically well-spread after sales service network; customers and dealers brand loyalty; and legal restrictions in the form of the "cab crash test". The Commission estimated the sunk costs of entry at EUR 25 million and appraised the costs as high in relation

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[213] Ibid. paras 95-96, 105. See chapter 5.1.
[214] Ibid. paras 80, 82, 97-107. See chapter 5.1.
[215] Ibid. paras 116-131. See chapter 5.1.
[216] Ibid. paras 139-142. See chapter 5.2.

to the likely returns and the total size of the market. Furthermore, it would take at least five years to establish a sufficiently large network to pose a competitive constraint on the concentration. Against this background and in conjunction with the limited evidence of past entry, the Commission concluded that entry by potential competitors was unlikely to occur. [217]

Buyer power depends on the ability and incentive of the buyers to switch to alternat sources of supply and due to customer loyalty to the Volvo and Scania brand, the new entity would be in a position to profit from their loyalty and increase prices according to the Commission. In addition, buyer power also depends on the symmetry between the buyers and the concentrations. The Commission found that the major customers only accounted for 10 per cent of the parties' sales and were thus more dependent on the concentration than the concentration on the customers. However, Volvo argued that the customers policy of dual sourcing or multi-sourcing rendered the customers with a negotiation advantage. The Commissions' market investigation, however, showed that more than 80 per cent of all Swedish heavy truck owners only had one brand in their fleet and therefore, the value of dual sourcing should not be overstated. The Commission concluded that there was no purchasing power among customers that would be able to restrain the concentration from exercising its market power and increase prices. [218]

6.6 Concluding Remarks

The Commission concluded that the relevant geographic market was national in scope in the *SCA/MetsäTissue* - case and in the *Volvo/Scania* – case. The possibility of suppliers to charge customers different prices in different countries as well as the presence of significant transport costs confirmed by the national purchasing patterns were decisive in the *SCA/MetsäTissue* - case. In the *Volvo/Scania* – case the price disparities between the different national markets and the switching costs in form of technical requirement and local after sales network confirmed by the purchasing patterns of the customers played a critical role.

In combination, the indication of the individual factors in the above-referred cases constituted evidence of a national market. The assessment of the individual factors seems to follow the principles presented in chapter 4. In addition, the combination of factors characteristic of the determination of a narrow (national) market as laid down in chapter 4.3. is partly at hand. Six out of ten factors were established in the *SCA/MetsäTissue* – caseand four out of six were established in the *Volvo/Scania* – case, indicating that price differences and switching costs confirmed by customers purchasing patterns are factors, crucial for the determination of the relevant geographic market.

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[217] Ibid. paras 100-104, 109, 133-138. 143.See chapter 5.3.
[218] Ibid. paras 110-115, 133, 144. See chapter 5.4.

The Commission concluded that the notified concentrations would create or strengthen a dominant position, significantly impeding effective competition. In the *SCA/MetsäTissue* – case, the merger would eliminate the main source of competition resulting in a concentration no longer facing any significant competitor. In addition, no potential competitors were found to exist to challenge the parties' very high market shares due to significant investment costs, including the cost of introducing a new brand, as well as insufficient countervailing buyer power to restrain the merged entity's market power. A single dominant position would be created in Denmark, Norway and Sweden and a duopolistic dominant position would have been created in Finland between the merged entity and Fort James.[219] This was also the case in *Volvo/Scania*, with the difference that no potential competitor was found to exist due to the very high investment cost. Furthermore, even if such a potential competitor existed, the entry would not be timely and a single dominant position would have been created in Sweden, Finland, Norway and Ireland.

The Commission's compatibility assessment appears to be in line with existing practice as outlined in chapter 5. In addition, almost all of the factors identified as indicators of dominance in chapter 5.6 existed in the *SCA/MetsäTissue* – case as well as in the *Volvo/Scania* – case. Despite this fact, there is one factor indicating dominance worth pointing out and discussing; the elimination of rivalry between the merging firms identified in both the *SCA/MetsäTissue* – case and the *Volvo/Scania* – case, strengthening the concentration's market power. The analysis of rivalry can as mentioned in chapter 5.1 may be misleading if the merging undertakings produce products that are not regarded by customers as close substitutes. Survey evidence may be used to assess customers' preferences for particular characteristics in products and have been applied by the Commission. However, an econometric technique is an alternative measurement of substitutability, developed and frequently used by the U.S antirust authorities. The econometric technique identifies the way in which sales lost by one product whose price increase will be distributed among other goods.[220] The degree of substitutability between the merging parties products were measured by the Commission in the *Volvo/Scania* – case on the basis that both brands were *generally perceived* as the expression of quality products and that the examination of Volvo's and Scania's respective market share clearly showed their essentially *parallel positions* throughout the whole of Europe. In the *SCA/MetsäTissue* – case the degree of substitutability between the merging parties products were assessed based on a customer survey finding that the parties' brands are generally considered as the *strongest and most well known brands* in Sweden. The Commission has thus in conclusion taken into account the closeness of the merging parties' products or the elimination of rivalry between them as a factor in the analysis of the creation or strengthening of a dominant position, but they have not carried out an in-depth econometric study, only depended on customer survey evidence of a general characteristic. However, the

[219] Navarro et al, p. 114.
[220] Baker, pp. 417, Lindsay, p. 187. Völker II, p. 400-401.

Commission requested an econometric study in the *Volvo/Scania* – case but did not base its findings on the results, largely due to their novelty and the disputes about the validity of the study.[221] However, a more in-depth analysis is desirable, because the differentiation or the substitutability of the merging parties' product can render the market share analysis either misleading or correct.

6.7 The Small Country Bias

In relation to smaller Member States, there have been criticisms regarding the Commission's decisions in certain cases, notably the *Volvo/Scania* - case, the *Föreningssparbanken/SEB* [222] – case and the *SCA/Metsä Tissue* - case, to define the geographic market as national rather than EEA wide. The criticism was based on the perceieved bias against mergers and acquisitions regarding large undertakings operating in small Member States and can be formulated as follows; when the Commission defines a small country as a national market it prevents undertakings from that country to merge because they would quickly reach dominance in the national market. This would prevent these undertakings from reaching the dimension necessary to compete worldwide. In large Member States, such a problem would not arise because undertakings could reach the necessary dimension without approaching the level of dominance.

The Commission has rejected the criticism as unfounded, stating that the objective in defining the geographic market is simply to identify the competitive constraints that the concerned concentration will face. When national concentrations do not face serious competition constraints from abroad, the market can only be defined as national, as in the cases mentioned supra. In addition, the purpose of the merger control system is to appraise the negative effects on any relevant market to the detriment of competition and the consumers, regardless of the markets size or of the country in which the concentration is based. Customers require protection against market power, i.e. higher prices, lower quality, lower production, less innovation, regardless of whether the consumers are based in a small or large Member States.[223] The Commission also researched their merger decisions since 1990 and found that 12 out of 18 prohibitions were related to domestic mergers, 3 in Germany, 2 In the Netherlands, 2 in the United States and 1 in France, South Africa, Sweden, Finland and the United Kingdom respecitively. Seven prohibitions of domestic mergers effected companies' headquarters in large economies and two concerned small countries. The Commission also researched Article 8 cases regarding concentrations in the Nordic countries since 1996, finding that in 6 out of 12 cases serious doubts were raised in at least one market defined as either regional or EEA-wide and in the remaining 6, national markets were considered. The data presented by the Commission does not support a

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[221] The *Volvo/Scania* – case, paras 71-75. Lindsay, p. 185.
[222] The notification was withdrawn according to Bernitz, p. 26.
[223] XXXth Report, para 236, Holgersson, p. 4-5, Lindsay, p. 140-141.

small-country bias in the Commission's merger control system. In addition, the undertakings in small Member States have the possibility to grow and become competitive worldwide through other means than by merging with another leading company from the same Member State; for example, to grow internally or to merge with companies that operate in other countries according to the Commission. [224]

The Commission applies the merger control on objective criteria, regardless of the size of the Member State the parties to the concentration are active in, and regardless of how the scope of the geographic market is defined, guaranteeing the consumers protection from the effect of dominance in small and large markets alike. As argued supra, there is no small country bias on the paper. Nevertheless, the practical outcome is that it is more likely that a dominant position is found to be held by large companies active in small countries, in a narrowly defined geographic market, in the sense that their possibilities to merge domestically are more limited than the possibilities by equally large companies in large countries. To this problem, there are two solutions according to Bernitz and Neven. The first is to work towards the real completion of the internal market, with one single market. As a result, the geographic market would be defined as EEA-wide. Secondly, the efficiencies generated by the merger should be able to counterbalance the anti-competitive effects of the merger. This cost-benefit approach is particularly important when the Commission defines the market narrowly.[225]

[224] XXXIst Report, paras 250-252, Speech of October 2001.
[225] Bernitz, p. 26-27, Neven, pp. 87.

7 The New Merger Regulation

7.1 Introduction

On December 11 2001, the Commission presented a Green Paper on the review of the Merger Regulation with the objective to (i) improve the Regulation's effectiveness and to (ii) take account of the greater economic complexity, which necessitates greater sophistication in the economic analysis of the cases before the Commission.[226] The Green Paper identified a number of weaknesses of the Merger Regulation and proposed an amount of changes upon jurisdictional[227], procedural[228] and substantive issues. The substantial issues considered in the Green Paper were the effectiveness of the compatibility test enshrined in Article 2 and in particular, on how this test compares with the substantial lessening of competition test, the SLC-test used in for example the U.S., and the Commission invited to a debate on the issue. [229] The Green Paper also pointed out that the Commission was aware of the ongoing debate on whether and to what extent efficiencies should be taken into account when carrying out the compatibility test and invited views on the proper role and scope of efficiency considerations in the field of merger controls.[230]

The consultation of the Green Paper was presented in a summary. As stated supra, the Green Paper launched a discussion on the merits of the compatibility test enshrined in Article 2 and whether the SLC-test, substantial lessening of competition, should be adopted. Respondents arguing in favour of the SLC-test considered the SLC-test a more appropriate standard for considering economic factors, avoiding a legal "straight-jacket" of establishing dominance. The basis for debate was that the compatibility test was too focused on static and structural considerations, such as corporate size or industry concentration, and does not allow for a sufficient consideration of dynamic and behavioural factors. Furthermore, some respondents in favour of the SLC-test considered the test better suited for dealing with the full range and complexity of competition problems that mergers could give rise to. Those who found a change to the SLC-test unnecessary considered that the current compatibility test is an

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[226] XXXIInd Report, para 284, Speech of April 2003.
[227] The Commission investigated the function of the turnover thresholds and purposed an automatic Community jurisdiction over concentrations subject to multiple filing in three or more Member States, the so called "3 + Model" according to the Green Paper, pp. 12, see also Annex 1. However, the suggested "3 + Model" was after further investigation not introduced in ECMR2 and the turnover thresholds in Article 1 remains thus the same according to the ECMR2 Proposal, paras 13-18 of the explanatory memorandum. See also the Report form the Commission to the Council on the application of the Merger regulation thresholds, COM (2000)399 final. As to the Commissions investigation of the referral system, see the Green Paper, pp. 20.
[228] As to the procedural issues, see the Green Paper, pp. 42.
[229] Green Paper, pp. 38.
[230] Green Paper, p 40-41.

effective merger control instrument and that the two tests pursue the same objective. Those who opposed a change viewed the SLC-test as a more vague, flexible and uncertain standard that would give the Commission a too broad discretion with an unacceptable degree of unpredictability as a result.[231] Regarding the debate of the proper role and scope of efficiency considerations in the field of merger control, most respondents considered that the Commission should allow for an efficiency defence that could mitigate a finding of dominance. The majority of the respondents favoured a restrictive approach, that the efficiencies must be concentration-specific, likely to be passed on to consumers, real reductions in marginal cost of production and that the burden of proof should lie with the parties to the concentration.[232]

Against the background of the Green Paper and the submissions the Commission proposed a new Merger Regulation with important substantive changes, which came into fore on May 1 2004. The Commission also published a Draft Notice on the appraisal of horizontal mergers in December 2002, which after consultation and modifications was adopted as Guidelines on the assessment of horizontal mergers[233] under the Merger Regulation on December 13, 2003.

7.2 Changes

7.2.1 The Geographic Market

The new Merger Regulation have not altered the assessment of the geographic market and remains thus the same as under the old Merger Regualtion.

7.2.2 The Compatibility Test

Based on the launched discussion regarding the effectiveness of the compatibility test and the consideration of the adoption of a new standard the Commission concluded that the compatibility test and the SLC-test in practice had produced broadly convergent outcomes, and that the compatibility test was in fact capable of dealing with the full range of anti-competitive scenarios. The Commission also concluded that the aim of ensuring that the compatibility test in the Merger Regulation would effectively cover all anti-competitive mergers was best served by clarifying the Merger Regulation itself. A clarification, in lieu of adopting a new test, also had the advantage of preserving the precedent built up under the Merger Regulation, including the body of case law the Courts have developed over the years, maintaining and guaranteeing a high degree of

[231] Green Paper Submissions, pp. 16.
[232] Green Paper Submissions, p 21-22.
[233] The Guidelines are closely related to the US Horizontal Merger Guidelines, according to Stirati, p. 272, Völker II, p. 403.

legal certainty. The new Merger Regulation therefore contains an improved compatibility test in Article 2(2), 2(3), which aims to clarify the concept of dominance under the Merger Regulation.[234]

In the old Merger Regulation the test was whether a concentration would lead to the;

"***Creation or strengthening of 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.*"[235]

In the new Merger Regulation, the test is whether a concentration would;

"***Significantly impede effective competition,*** *in the Common Market or in a substantial part of it,* ***in particular as a result of the creation or strengthening of a dominant position***."[236]

Part of the second element of the old test "significantly impediment of effective competition" as well as the first element of the old test "the creation or strengthening of a dominant position" is retained. The difference is that the second element "significantly impediment of effective competition" is turned into the principal test and "the creation or strengthening of a dominant position" serves as an example of such significant impediment. The decisive criterion of the new test is whether there is a significant impediment to effective competition and the new compatibility test thus makes it clear that it is applicable on all anti-competitive concentrations, which would be able to practice influence on the market by raising prices, reducing choice or innovation.[237]

When the Commission assesses a concentration's compatibility with the Common Market under the new test, the Commission must take any significant impediment to effective competition likely to be caused by the concentration into account. However, the wording of the compatibility test clearly shows that the concept of dominance continues to be present and thus provides an important indication as to the standard of competitive harm that is applicable when determining whether a concentration is likely to impede effective competition to a significant degree. The concept of dominance was defined in the context of the old Merger Regulation as;" *a situation where one or more undertakings yield economic power which would enable them to prevent effective competition from being maintained in the relevant market by giving them the opportunity to act to a*

[234] ECMR2 Proposal, para 55 of the explanatory memorandum, XXXIInd Report, paras 289- 290, XXXIIIrd Report, para 203, Steiner, p. 158, Wetter et al, p. 672-673, Speech of November 2002, Speech of April 2003.
[235] ECMR1, Article 2.
[236] ECMR2, Article 2.
[237] XXXIIIrd Report, para 218, Schmidt, Stirati, p. 254, p. 1566-1567, Steiner, p. 158, Völker 11, p. 403, Witter et al, p. 659.

considerable extent independently of their competitors, their customers and, ultimate of consumers."[238] To that effect, the clarification of the compatibility test is consistent with how the Court of Justice has defined dominance in mergers and acquisitions and thereby seeks to maintain the sizeable body of case law and case practice, which developed over the years.[239]

Nevertheless, the creation or strengthening of a dominant position held by a single firm as a result of a merger or acquisition has been the most common basis for finding that a concentration would result in significant impediment to effective competition. Furthermore, the concept of dominance has also been applied in an oligopolistic market structure in cases of collective dominance. Consequently, it is expected that most cases of incompatibility will continue to be based upon a finding of dominance. [240]

The change of the criterion implies that the potential of prohibiting mergers and acquisitions has markedly increased, but the change of the criterion also implies that the test enables the Commission to clear a concentration that creates or strengthens a dominant position but does not significantly impede effective competition. [241]

7.2.3 Judging Significant Impediment According to the Guidelines

The Guidelines adopted in December 2003 gives comprehensive guidance as to how the Commission will assess the likely impact of a concentration on competition. The Guidelines are designed to complement the re-wording of the Merger Regulation's compatibility test for assessing the competitive impact of mergers as well as indicating the presence or absence of prima facie competition concerns. The Guidelines largely codify existing practice, but also contains some elements that points to modification of the Commissions practice.[242]

7.2.3.1 Possible Anti-Competitive Effects of Horizontal Mergers

The Guidelines makes it clear that the central question is whether the market power is enhanced in a manner that is likely to have adverse consequences for consumers, in the form of increased prices, poorer quality of products, reduced choice or reduced innovation.[243] Although the new compatibility test does not alter the Commissions approach to the analysis of the

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[238] Guidelines, recital 2.
[239] Guidelines, recital 4, ECMR2 Proposal, para 56 of the explanatory memorandum, Speech of November 2002.
[240] Guidelines, recital 4, Schmidt, p. 1567.
[241] Schmidt, p. 1566-1567, Stirati, p. 254, Völker 11, p. 403.
[242] XXXIIIrd Report, paras 218-219, Völker I, p. 1060.
[243] XXXIIIrd Report, paras 218-219, see also chapter 5.4.

competitive impact of concentrations, the rewording of the test makes it clear that the focus is on concrete competitive effects, in terms of price increases and output restrictions, rather than on market power/dominance and the market structure.[244]

The Guidelines explain that mergers may result in competitive harm either because the concentration eliminates a competitor from the market, thereby removing an important competitive constraint (i.e. the concentration gives raise to unilateral or non-coordinated effects), or because it makes coordination between the remaining firms more likely (i.e. the concentration give rise to coordinated effects).[245] The Guidelines section of coordinated effects essentially summarizes the case law of the Commission[246] and the Community Courts on collective dominance and will not be further discussed, as the focus of the thesis is on the appraisal of horizontal mergers resulting in single-firm dominance or non-coordinated effects.

The Guidelines section on non-coordinated effects contains a number of factors which may influence whether significant non-coordinated effects are likely to result from the merger or acquisition, recognised from the dominance assessment in chapter 5. The non-exhaustive list of factors are the following:

(i) the merging firms have a high market share[247]
(ii) the merging firms are close competitors[248]
(iii) the consumers have limited possibilities of switching suppliers[249]
(iv) the remaining competitors cannot respond with increased quantities to a price increase of the merged entity[250]
(v) the merged entity has the capacity to hinder new market entry[251]

However, as stated supra, the focus when assessing these factors is clearly on concrete competitive effects, in terms of price increases and output restrictions, rather than on market power/dominance. Nevertheless, the concept of dominance provides an important indication as to the standard of competitive harm that is applicable when determining whether a concentration is likely to impede effective competition to a significant degree. The change in focus from dominance to price increase and output restriction is just an alteration of words in order to adapt the assessment to concentrations, which significantly deter effective competition but do not

[244] ECMR2, recital 25, ECMR2 Proposal, para 55 of the explanatory memorandum, XXXIInd Report, para 290, Steiner, p. 158, Schmidt, p. 1567, Wetter et al, p. 672-673, Völcker I, p. 1060, Speech of November 2002, Speech of April 2003.
[245] Guidelines, para 22 .
[246] Völcker I, p. 1061, Speech of April 2003. As to the appraisal of horizontal mergers resulting in coordinated effects, see the Guidelines, paras 39-57.
[247] Guidelines, para 27, see also chapter 5.1.
[248] Guidelines, paras 28-30, see chapter 5.1.
[249] Guidelines, para 31, see chapter 5.2.
[250] Guidelines, paras 32-35, see chapter 5.2.
[251] Guidelines, paras 37-38, see chapter 5.3.

create or strengthens a dominant position.[252] For example, the consideration of market shares has been modified to include the concentrations, which does not necessarily lead to dominance by stating that the higher the post market share or the higher the addition of market share, the more likely it is that the concentration finds it profitable to increase price.[253] In addition to the change in focus, the codification of existing practice in the Guidelines provides predictability and transparency regarding the Commission's merger analysis.[254] To some extent, the codification is also a clarification. For example, the consideration of actual competitors has been clarified, stating, "*When market conditions are such that the competitors of the merging parties are unlikely to increase their supply substantially if prices increase, the merging firms may have an incentive to reduce output below the combined pre-merger levels, thereby raising market prices.*"[255] The consideration of actual competitors remains the same as in chapter 5.2, but it is more clearly written. The consideration of entry barriers in the Guidelines has also been clarified, stating that the barriers to entry in the form of absolute and strategic advantages, which the concentration possesses, can be used to make it more difficult for smaller actual competitors to expand. In such a case, competitors may not either individually or aggregately, be in a position to constrain the merged entity to such an degree that it would not increase prices or take other actions detrimental to competition.[256]

7.2.3.2 Indications of Competition Concerns

The Guidelines contain certain market shares and concentration levels that may indicate the presence or absence of prima facie competition concerns. In particular, the Guidelines indicate levels of market shares and concentrations where the Commission is likely and respectively unlikely to examine concentrations. In cases where the combined market shares are below 25 per cent or where the overall market concentration is low, or where a post-merger HHI of less than 1000 exist, the Commission is unlikely to investigate the concentrations. In cases where the combined market share exceeds 50 per cent, there is a presumption of incompatibility with the Common Market.[257]

7.2.3.3 Countervailing Benefits

The Commission was of the standpoint that concentrations were to be judged based on their anti-competitive effects alone, and that there was no

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[252] ECMR2, recital 25, ECMR2 Proposal, para 55 of the explanatory memorandum, XXXIInd Report, para 290, Steiner, p. 158, Wetter et al, p. 672-673, Völcker I, p. 1060, Speech of November 2002, Speech of April 2003.

[253] Under ECMR1, the consideration was that a large market share is associated with market power/dominance, which refers to the ability to profitably raise prices, see chapter 5.1. Guidelines, para 27.

[254] XXXIInd Report, para 291.

[255] Guidelines, para 32, see chapter 5.2.

[256] Guidelines, para 36, see chapter 5.3.

[257] Guidelines, paras 17, 18, 19, Draft Notice, paras 16, 20. See chapter 5.1, 5.2.

explicit provision under the Merger Regulation that could be used to consider efficiencies generated by the concentration, until the adoption of the Guidelines in 2003. Today, the Commission recognises that Article 2(1)b of the Merger Regulation provides a legal basis in that respect by stating that the Commission shall take into account of "*the development of technical and economical progress provided it is to consumers' advantage and does not form an obstacle to competition.*" Furthermore, the Guidelines now recognise that efficiencies brought about by a merger can counteract the detrimental effects on competition and consumers that it otherwise may have.[258] The question of to what extent efficiencies should be taken into account when carrying out the compatibility test has also been answered in the Guidelines, which stipulates that the Commission will carefully consider any substantiated efficiency claim in its overall assessment of the likely impact of a merger on competition. However, for such efficiencies to be considered there has to be sufficient evidence that the efficiencies benefit consumers, are merger-specific and verifiable.[259]

The Guidelines identifies the principles, which will be applied in appraising efficiency claims. Thereby defining the proper role and scope of efficiency considerations in the field of merger control. The principles are as follows:[260]

Benefit to consumers

The benchmark for assessing efficiency claims is that consumers will not be worse off as a result of the merger. For that purpose, the efficiencies should be substantial and timely and benefit consumers in the relevant market where it is otherwise likely that competition concerns would occur.[261]
Thus, the following question arises; what efficiencies are benefiting to consumers? Mergers can result in efficiency gains to the benefit of consumers in several ways;

(i) by allowing better exploitation of economies of scale. Short-term economies of scale may result from the elimination of a duplication of fixed costs and from rationalisation in production that lowers marginal costs. Long-run economies of scale may be realised if the formerly separate undertakings investments in physical capital are combined and integrated in production, research, development, and marketing.

(ii) by allowing for economies of scope, arising when the cost of producing two products is lower than the sum of the costs of producing them separately.

(iii) by enhancing technological progress, which may arise from the

[258] Guidelines, para 76, ECMR2 Proposal, para 60 of the explanatory memorandum, Draft Notice, paras 87-88, XXXIInd Report, para 294, Völcker I, p. 1061, Speech of April 2003, Speech of November 2002, Hintern-Reed, p. 461.
[259] Guidelines, paras 77, 78, Draft Notice, para 90, XXXIIIrd report, para 220.
[260] Hintern-Reed, p. 461. As to the principles, they seem to be based on the findings of the Study on the Efficiency Defence.
[261] Guidelines, para 79.

diffusion of know-how and from the increase in incentives for R&D activities.

(iv) by increasing the bargaining power of the new entity and

(v) by improving the efficiency of management

The efficiencies described supra are often divided into two categories; efficiencies leading to reduction of fixed costs and efficiencies leading to reduction of marginal costs or variable costs. This serves as an important distinction, because reduction of marginal costs tends to benefit the consumer to a larger extent. [262] The above-described efficiencies benefit the consumers to the extent that the efficiencies lead to the *ability* of the entity to reduce price, to develop new products or to improve the quality of the products. Efficiencies leading to a lower price are specifically cost saving in production or distribution and efficiencies leading to the development of new or improved products are specifically efficiency gains in research, development and innovation according to the Guidelines.[263] Nevertheless, the later the efficiencies are expected to materialise in the future, the less weight the Commission will assign to them. In addition to the ability to benefit consumers due to efficiency gains, the merged entity must also have the *incentive* to pass on the efficiency gains to the consumers. However, the efficiencies generated must not be exclusively for the benefit of the consumers, they might be shared between producers and consumers as long as the consumers receive direct benefits. Whether the entity will have an incentive to pass on efficiency gains to the consumers is related to the existence of competitive constraints posed by actual and potential competitors. Thus, the less competitive constraint posed on the merged entity, the more the Commission has to be sure that the claimed efficiencies are substantial, likely to be realised and passed on to a sufficient degree to the consumers. It is highly unlikely that a concentration will be declared compatible with the Common Market, on the ground that efficiency gains would be sufficient to counteract its potential anti-competitive effects, where the level of market power is close to that of a monopoly. [264] In conclusion, efficiencies generated by the concentration are most likely to make a difference when they are substantial and when the possible anti-competitive effects that otherwise might occur are small.

Merger specificity

The efficiency gains are merger specific if they are a direct consequence of the concentration. If the efficiencies can be achieved to a similar extent by less anti-competitive, realistic and attainable alternatives, the Commission will disregard the efficiency gains in the competitive assessment. The burden of proof to demonstrate that there are no less anti-competitive,

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[262] Study on the Efficiency Defence, p. 8-9, pp. 39, Report on Unilateral Effects, p. 63, Guidelines, para 80, Knable, pp. 277, Colley, p. 347, Neven, pp. 88.

[263] Guidelines, paras 80-81, Draft Notice, paras 91,92.

[264] Guidelines, paras 83-84, XXXIInd report, para 295, Speech of November 2002, Colley, p. 346-347.

realistic and attainable alternatives to produce the efficiencies lies on the parties of the concentration.[265]

Verifiability

There is a trade-off between efficiency gains from the merger and the increase in market power. However, difficulties arise when assessing whether the efficiencies generated are substantial enough to counterbalance the anti-competitive effects the mergers that otherwise would have been brought about. This requires a cost-benefit analysis that identifies the modes of competition before and after the merger, a quantification of the anti-competitive effects in form of the expected increase in price and a quantification of the efficiency gains.[266] The cost-benefit analysis is a difficult task, and therefore, the efficiencies generated by the concentration must be verifiable to the extent that the Commission can be reasonably certain that the efficiencies are likely to materialise and be substantial enough to counteract the concentrations potential harm to consumers. The more precise the claims, the easier it is for the Commission to evaluate them. If it is not possible to quantify the efficiency claims, for example if the data is unavailable, the efficiency must be foreseeable and there have to be a clearly identifiable positive impact on consumers in order to consider the efficiency claims. The longer the efficiencies are projected into the future, the less weight can the Commission assign to them. The reason being that efficiencies are prospective and less predictable the further into the future they will materialise.

The burden of poof to demonstrate the claimed efficiencies are merger-specific, likely to be realised and substantial enough to be likely to counteract anticompetitive effects that the merger might otherwise have and therefore benefit consumers, lies on the parties of the notified concentration. Evidence relevant for the assessment of efficiency claims are; internal documents that were used by management to decide on the merger, statements from the management to the owners and financial markets about the expected efficiencies, historical examples of efficiencies and consumer benefit, pre-merger external experts' studies on the size and type of efficiency gain and the extent to which consumers are likely to benefit.[267]

The Commission will carefully consider any efficiency claim on a case-by-case basis in the context of the overall assessment of a merger, and may ultimately decide that, as a consequence of the efficiencies that the mergers bring about, the merger does not significantly impede effective competition, in particular as a result of the creation or strengthening of a dominant position.[268]

[265] Guidelines, para 85, Draft Notice, para 93.
[266] Study on Efficiency Defence, p. 19-20,28, Report on Unilateral Effects, p. 66.
[267] Guidelines, paras 86-88, Draft Notice, paras 94,95, Lindsey, p. 443.
[268] XXXIInd Report, para 293.

7.3 Concluding Remarks

The objective of the review of the Merger Regulation was to (i) improve the Merger Regulations effectiveness and (ii) take account of the greater economic complexity, which necessitates greater sophistication in the economic analysis of the cases before the Commissions.

The first objective is partially fulfilled as all concentrations, which deter competition, are covered enabling the Merger Regulation to deal with the full range of anti-competitive scenarios, which would be able to practice influence over the market by raising prices, reduce choice or innovation. The Regulation thus avoids the legal straight jacket of creating or enhancing a dominant position. However, this is only avoided to a certain degree, because the concept of dominance is a primary form of significant impediment to competition. The change in focus to concrete competitive effects, in terms of price increases and output restrictions, rather than on market power/dominance and the market structure allows for a more dynamic and effective assessment of competition concerns, including efficiency gains. However, the inclusion of efficiency gains in the appraisal of concentrations gives rise to practical difficulties in verifying and quantifying efficiency, while balancing efficiency gains against anti-competitive effects of the merger. The Guidelines could have been more specific and precise regarding the role of efficiencies. They are abstract, and will therefore increase the discretionary leeway of the Commission, which in turn leads to a decrease in predictability. Nevertheless, the role of efficiencies in merger review is still evolving and the predictability will develop as cases are decided.

In addition, the precedent developed over the years is also preserved, enhancing the effectiveness of the new Merger Regulation and also maintains and guarantees a high degree of legal certainty. The Guidelines also give comprehensive guidance as to how the Commission will assess the likely impact of a concentration on competition largely codifying existing practice, providing predictability and transparency regarding the Commission's merger analysis. Overall, the effectiveness of the Merger Regulation is enhanced.

The second objective to take account of greater economic complexity and apply a greater sophistication in the economic analysis is possible to fulfil. It is up to the Commission to actually use the tool provided, in order to take account of the economic complexity and carry out a more sophisticated analysis. The tool referred to is the econometric tool, also known as merger simulation used by the U.S. antitrust authorities.[269] The merger simulation allows for a quantitative assessment of the impact of a merger on prices on the market, and is based on two econometric techniques;

[269] Völker II, p. 405.

(i) the tendency for prices to rise following the elimination of competition between the merging parties, and
(ii) the tendency for prices to fall if efficiencies are sufficient

With information on customer preferences and the impact of the merger on costs, these two separate influences on the new entity's pricing incentives can be combined and the unilateral effects of a merger can be simulated. The analysis is very flexible, it can be used to identify the degree of substitutability between the merging firm's products, to quantify efficiencies as well as altogether analyse the unilateral effects of a concentration providing an alternative approach to assess a concentrations compatibility with the Common Market.[270] Insofar, the Commission has taken into account the tendency for prices to rise following the elimination of competition between the merging parties due to the degree of substitutability between the merging parties' products as a factor in the compatibility assessment but have yet not carried out an in-depth econometric study, only depended on customer survey evidence.[271] However, in the *Volvo/Scania* - case in 1997, the Commission used an econometric technique, although did not base its findings on the results, largely due to their novelty and the disputes as to the validity of the study.

Regarding the consideration of efficiencies, it is a novelty in European competition law. The Guidelines offer a little solace as to how the cost-benefit analysis of efficiencies will actually be carried out. We have, in conclusion, an "imperfect" substitutability assessment and a novel efficiency assessment as well as a new compatibility test. On the other hand, there is the US sophisticated, complex merger analysis, which assesses whether the products are close substitutes, makes the efficiency consideration operational, and offering a unique insight into the extent which efficiencies will mitigate competitive effects. The merger simulation is overall a useful guide to assess concentrations, increasing focus and accuracy of the analysis.[272] However, the question of whether the merger simulation is an appropriate tool in the European context arises. Based on the fact that the European definition on the relevant market and the assessment of unilateral effects, as laid down in the Guidelines, closely that used in U.S. Antitrust law, indicates that the Merger Simulation is an appropriate tool not only in the US but also in the European context. The question is therefore whether there will be a shift to the U.S. analysis in the European Union. Evidence exists that the Commission is showing a growing interest in econometric analysis and is increasingly using these techniques, for example in the *GE/Instrumentarium* - case.[273] This in conjunction with

[270] Colley, pp. 342. See also Colley, pp. 345 and Werden, pp. 75 for an example of a merger simulation.
[271] See chapter 5.1 and 7.2.3.1.
[272] Colley, pp. 342, Völker II, p. 405-406, Werden, p. 76-77.
[273] Bishop, p. 69-70, Colley, pp. 342, Völker II, p. 405, In Case No IV/M.3083 *GE/Instrumentarium* OJ L 109/01 16.04.2004 the Commission found that combined with the high market share, the economic data reinforced the presumption that the parties could raise price post-merger and thus supported the Commission's dominance finding. The economic data used was for example statistical analysis based on the bidding data supplied

the appointment of a Chief Economist, Lars-Hendrik Roeller, who is a recognised expert in antitrust economics and the use of quantitative techniques, the trend, is bound to be continued. Moreover, the new Merger Regulation gives the Commission the option to extend the deadline in complex cases if it requires more time for analysis, giving the Commission the ability to conduct this extensive econometric study. Nevertheless, it will take time until the Commission reaches the same level of sophistication and widespread use of econometric evidence as in the U.S. but it is expected that the Commission will give meaning to the new compatibility test and actively explore the boundaries of the unilateral effects analysis.[274]

by all four competitors, a win/loss analysis of that data as well as an analysis of the pricing of the bids submitted when the parties of the concentration faced each other and when they faced other competitors, see Völker II, p. 399.

[274] Völker II, pp. 405.

8 Concluding Remarks And Discussion

The central element in competition analysis is the definition of the relevant geographic market. The purpose of defining the relevant geographic market is to identify all the relevant competitive forces that the parties of the concentration actually faces that are capable of constraining the behaviour of the notified concentration and of preventing the notified concentration from behaving independently of effective competitive pressure. The geographic market definition is thus crucial for the compatibility assessment and may affect the outcome of a case in a determinant manner as seen in the *Metsä/Tissue* – case and the *Volvo/Scania* – case. The factors assessed by the Commission and their indication of a wide and narrow market definition has been identified and presented in a table. When writing this thesis a lack of an overview of the factor pointing towards a wide or a narrow geographic market was discovered and the table thus provides useful information for the parties to a concentration arguing for a wide market definition. In addition, the considerations of the Commission when assessing a concentration‘s compatibility with the Common Market has been identified and an overview of the factors' detriment for a finding of dominance has been outlined, enabling the parties to a concentration to assess their arguments and provide the Commission with information to evidence compatibility with the Common Market.

An economic analysis provides a helpful tool when determining the relevant geographic market and when assessing a concentrations compatibility with the Common Market. The role of economic analysis in the EC merger control regime is evolving; the new Merger Regulation provides a more economic approach and the new compatibility test is deemed to strengthen the economic analysis of prospective concentrations by balancing both the anti-competitive and the pro-competitive effects of a merger. The new Merger Regulation thus reflects a shift from a predominantly legalistic approach to a more economic approach. The focus shift from market dominance to significant impediment of effective competition can transform the Merger Regulation from a market share test to one using econometric tools to measure market power. The objective of the new Merger Regulation is to take complex economic cases before the Commission into account and to provide for a more sophisticated economic analysis. Competition law is economic law and since economic analysing techniques have improved over the last years, these improvements should be applied in a modern competition assessment. Whether this will be the case, whether the American econometric model discussed will be applied, partly measuring product differentiation or efficiencies or as a whole in the form of merger simulation, is left to the Commission to decide and insofar there has not been a published Article 8 decision. If the Commission will apply the

merger simulation, the new Merger Regulation will narrow the gap between law and economics in the field of competition.

8.1 The SCA/MetsäTissue - Case and The Volvo/Scania – Case in the Light of the New Merger Regualtion

The appraisal of the cases was found to be consistent with existing practice. However, since the cases were deemed incompatible with the Common Market a new Merger Regulation has come into force and the question thus arises whether the *SCA/MetsäTissue* – case and the *Volvo/Scania* – case could be found compatible with the Common Market if appraised under the changed Merger Regulation.

The compatibility test remains practically the same, the only alteration being that a concentration does not have to create or strengthen a dominant position; it is enough if effective competition is significantly impeded. Thus, a concentration with high market shares, such as *SCA/MetsäTissue* and *Volvo/Scania*, is now cleared as long as the concentration does not significantly impede effective competition. The requisite for finding a concentration incompatible with the Common Market has thus been lowered. Nevertheless, according to the Commission, the creation or strengthening of a dominant position provides a good indication as to whether a concentration will significantly impede effective competition or not. Since the Commission assessed the *SCA/MetsäTissue* – case and the *Volvo/Scania* – case as creating or strengthening a dominant position, the above described indicates that the Commission would find both cases as significantly impeding effective competition under the New Merger Regulation.

There is nevertheless an alteration of the compatibility assessment that might lead the Commission to clear the *SCA/MetsäTissue* and the *Volvo/Scania* transaction if they were to be assessed under the new Merger Regulation. The alteration in question is the introduction of the appraisal of the efficiency gains a merger will bring about. The Commission will acknowledge arguments of efficiency gains in the form of economies of scale and scope and increased bargaining power leading to cost reductions, which the customers and consumers will benefit from. In addition the Commision will consider efficiency gains in the form of technological progress leading to increased innovation resulting in new products, higher quality of the product or a greater variety of products that will benefit the customers and consumers.

However, there are four inherent pitfalls when arguing efficiency gains. The first refers to the difficulty in evidencing that the efficiencies will benefit the consumers and the second refers to the difficulty in evidencing the merger specificy of the efficiency gains. The efficiencies have to be shown to be a

direct consequence of the merger and the parties to the concentration have to show that the efficiencies cannot be achieved by less anti-competitive realistic alternatives. The third refers to the difficulties in evidencing that the efficiency gains are likely and the fourth pitfall is due to the problem of verifying and quantifying efficiency gains. The parties to the concentration have to show that the efficiencies generated are substantial enough to counterbalance the anti-competitive effects the mergers otherwise would have brought about in order for the Commission to apply a cost-benefit analysis. The burden of proof results in two costs for the parties to the concentration. First, the parties will incur costs in collecting and processing information in order to prove the claimed efficiencies arises. Second, costs in reporting the information to the competition authorities in a persuasive manner to increase the likelihood of having the merger cleared will arise.[275] An application of the American econometric technique of merger simulation would simplify the analysis, however, the cost of evidencing the efficiencies remains.

The Commission might nevertheless be in a position to establish that the *SCA/MetsäTissue* and the *Volvo/Scania* concentration are incompatible with the Common Market under the new Merger Regulation according to para 84 of the Guidelines: ”*It is highly unlikely* ***that a merger leading to a market position approaching that of monopoly, or leading to a similar level of market power****, can be declared compatible with the Common Market on the ground that efficiency gains would be sufficient to counteract its potential anti-competitive effects”* If the Commission considers a market share of 90 per cent respectively 90.8 per cent to be a market position approaching that of monopoly or a similar level of market power, the efficiency gains alone will not clear the transactions. However, if the parties are able to show that there are actual and potential competitors in conjunction with efficiency gains, there is a possibility for the Commission to clear the transactions.

On the other hand, if the Commission were to apply the merger simulation analysis both regarding the substitutability of SCA’s and Metsä Tissue’s products, Volvo’s and Scania’s products, and regarding the efficiency gains, the analysis might lead to the fact that the products are differentiated resulting in the combined market shares of the parties do not properly indicating market power enabling efficiency gains to counterbalance the anti-competitive effects of the merger.

In the light of the supra described facts and implications questions arise~~s~~ as to whether the *SCA/MetsäTissue* - case and the *Volvo/Scania* – case would be found as compatible with the Common Market under the new Merger Regulation as well as whether the effect of the small county bias in practice has been eliminated. The arguments of efficiency gains will probably represent another battleground for the European Commission, the lawyers and the economists.

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[275] Stirati, p. 268.

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