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-Efficiency in Community merger control

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Summary

This thesis presents a closer look into the application of the Merger Regulation on various transactions concerning the concentration of undertakings, and it begins with an analysis of the legislative winds of change leading up to its adoption, followed by a closer assessment of some of the results of the reform with relevance to the basic theme of the thesis, namely efficiencies.

Furthermore, the thesis offers a presentation of some essential cases in combination with an assessment of the merging parties' possibilities to present defences and commitments in order to ensure their proposed merger's approval. It also provides a brief review of the highly debated concept of an efficiency offence in Community merger control.

The next section deals with the issue of efficiencies and the position they hold in merger assessments. In this area, the thesis is aimed at offering a variety of perspectives on the concept of efficiencies. The thesis will also touch upon the issues of consumer welfare as an incentive behind Community merger control. The thesis does certainly not aspire to present a complete depiction of the economic aspects of European merger control and the function of efficiencies, as this would be too daunting a task at this level.

In order to close up the bag the thesis also offers an attempt to evaluate the possible future of Community merger control, particularly with regards to the effects of the abovementioned reform.

The last chapter contains some brief concluding remarks.

The overall analysis of the Community Competition Law will be limited to the Merger Regulation and will not linger on the legal provisions of the EC Treaty in articles 81 and 82.

1 Introduction

When companies wish to merge their respective businesses, the Community has an interest in making sure that the results of the merger do not cause detriment to common market competition. Consequently, Community legislation has been passed regulating these so-called concentrations of undertakings. The Council Regulation No 4064/89 EEC¹ has been the backbone of Community merger control, and as of 1 May 2004 it has been replaced by Council Regulation No 139/2004 of 20 January 2004 on the control of concentrations between undertakings.²

According to the rules contained in the Merger Regulation, concentrations are only allowed to carry on as long as they do not cause a significant impediment of effective competition in the common market or a substantial part of it. The responsibility to supervise concentrations and prohibit operations that are incompatible with the common market lies with the European Commission.

Around the beginning of the new millennium, doubts were conveyed as to the strength of the former Merger Regulation in dealing with the highly sophisticated merger transactions that are presently occurring as a result of the increasing element of globalisation and internationalisation of the current business situation. The Commission was accused of passing concentrations that had consequently caused impairment on competition, and also of disallowing concentrations that might, had they been allowed to continue, have contributed to the maintenance of a healthy level of competition in the market in question.³

Voices were raised suggesting a change in the Commission's method utilised when evaluating the plausible effects of concentrations of undertakings. Part of the suggestion concerned the adding of an outright element of efficiency to the evaluation process, allowing the merging companies to state an efficiency defence. This suggestion and others were brought forward in the Commission's Green Paper of December 2001, aimed at launching a debate on the functioning of the merger control of the European Union. After wide-ranging consultations, an extensive reform package was adopted by the Commission in December 2002. This resulted in the above-mentioned Merger Regulation containing a new substantive

¹ The Council Regulation (EEC) No 4064/89 of December 1989 on the control of concentrations between undertakings O.J. 1989 L395, as last amended by Regulation EC No 1310/97. Hereafter referred to as the former Merger Regulation.

² Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings O.J. 2004 L 24. Hereafter referred to as the Merger Regulation.

³ Neven, Damien J.; Röller, Lars-Hendrik, article "Discrepancies between markets and regulators: An analysis of the first ten years of EU merger control" from the Swedish Competition Authority's 10th anniversary publication "The pros and cons of merger control", Stockholm 2002, p. 13

test to be applied in merger assessments, along with the adoption by the Commission of Guidelines on the Assessment of Horizontal mergers aimed at enhancing the level of legal certainty in the merger control appraisals.

1.1 Purpose

The aim of this thesis is to present a closer look into the application of the Merger Regulation on various transactions concerning the concentration of undertakings. To pursue this aim it presents an assessment of the changes that have recently taken place in the area of merger control with a closer scrutiny of the possibility for companies to state an efficiency defence in merger cases notified to the Commission.

Merger control should perhaps be the most obvious focus of competition policy. The reason being that growth by acquisition of a competitor rather than growth by market expansion can be said to represent an easy way to achieve monopoly power. It rids the playing field of a competitor, which will probably lead to positive effects on the acquiring company's business activities. But mergers and acquisitions can also offer the kinds of economic benefits that market expansion cannot. First, the opportunity to recombine the respective corporate assets in a more efficient manor, and second, the ability for capital markets to supervise the management's performance and allow for new owners to replace the managers whose performance it finds inadequate.⁴ The focus of this thesis will be on the first economic benefit mentioned above; the possible efficiency gains of a merger situation.

1.2 Outline and Delimitation

In order to achieve the above stated purpose the thesis will start with an analysis of the legislative winds of change leading up to the adoption of the EC Merger Regulation followed by a closer assessment of some of the results of the reform with relevance to the basic theme of the thesis, namely efficiencies.

The following chapter offers a presentation of some essential cases in combination with an assessment of the merging parties' possibilities to present defences and commitments in order to ensure their proposed merger's approval. It also provides a brief review of the highly debated concept of an efficiency offence previously present in Community merger control.

In the next chapter focuses will be on the specifics of efficiency gains that may be the result of concentrations of undertakings. The chapter aims to offer a variety of perspectives the concept of efficiencies.

⁴ Neven, Damien; Nuttall, Robin; Seabright, Paul, "Merger in daylight: The Economics and Politics of European Merger Control", London 1993, p. 11

After that, the thesis offers an attempt to evaluate the possible future of Community merger control, particularly with regards to the effects of the abovementioned reform.

The final chapter contains some brief concluding remarks.

The analysis will be limited to the Merger Regulation and will not touch upon the legal provisions of the EC Treaty in articles 81 and 82.

This thesis does certainly not aspire to present a complete depiction of the economic aspects of European merger control and the function of efficiencies, as this would be too daunting a task at this level.

1.3 Method and Material

Throughout this thesis the analytical elements will be woven into each respective chapter, rather than being gathered under one singular heading. The final chapter offering concluding remarks is not to be considered as an analysis, but merely as an attempt to recapitulate the basic theme of the essay and provide a bold and certainly somewhat unrealistic, yet interesting solution to the problems occurring in current merger control, regarding the non-convergence of merger control systems world-wide.

In this thesis, the words “concentration” and “merger” will be utilised interchangeably in order to keep the language from being perceived as too repetitious, i.e. no substantial difference in the significance of the words is intended.

The material utilised in this thesis consists mainly of Commission decisions adopted under the Merger Regulation. As secondary sources of information a range of articles and publications have been utilised to achieve the above stated purpose, predominantly material originating from the European Union such as, f. ex. the Commission’s Annual Reports on Competition Policy and the Competition Policy Newsletter. However, a large portion of the material utilised consists of the opinions of other authors as expressed in a number of articles and dissertations.

I would also like to point out that some of the material that constitutes the foundation of this thesis should be viewed with a healthy amount of scepticism.

2 The Merger Regulation

2.1 Background

Competition policy was one of the first areas of continuous legislative and judicial activity in the European Communities and by the early 1970's there had developed a considerable quantity of case law and secondary legislation complementary to the main provision of the Treaty of Rome. Lacking from this elaborate system of legal control were however regulations regarding the control of mergers. Such provisions had earlier been included in article 66 of the European Coal and Steel Community Treaty, but this was not repeated in the EEC Treaty.⁵ This omission of an explicit merger control provision resulted in efforts to achieve some level of control of merging activity within the Community by using articles 81 and 82 EEC (previously 85 and 86).

But the Commission was not content with this rather inefficient merger control system and wanted the opportunity to assess mergers before their actual consummation in order to assess mergers that might lead to a dominant position. On 21 December 1989, the Council adopted Regulation 4064/89 thus granting the Commission the necessary powers to do so.⁶ The Regulation was amended in 1997 and ultimately replaced by Regulation 139/2004 that came into force on May 1 2004.

Leading up to the actual introduction of the current Merger Regulation was an extensive overhaul of EU merger control, which will be summarized below in order to present a more complete illustration of the current Community merger control environment.

2.2 The reform of EU merger control

On 11 December 2001, the Commission adopted a Green Paper on the Review of Council Regulation (EEC) No 4064/89.⁷ The reason for launching this overhaul of the Community merger control system was that the European Union is continuously experiencing new challenges resulting from the increased globalisation of cross-border mergers, advances in market integration and the introduction of the Euro.⁸ Another important rationale behind the renovation decision was the then pending enlargement

⁵ Lane, Robert, "EC Competition Law", Harlow 2000, p. 256

⁶ Korah, Valentine, "An introductory guide to EC Competition Law and Practice", Oxford, 2004, 8th edition, p. 6

⁷ Green Paper on the Review of Council Regulation (EEC) 4064/89 COM [2001] 745 final, of 11.12.2001. The full text of the Green Paper is available on the DG Competition website: <http://europa.eu.int/comm/competition/mergers/review/>

⁸ European Union Competition Policy, XXXI:st report on competition policy, p. 83

of the European Union to 25 or more Member States. Another reason for the overhaul to be instigated was perhaps that the Commission had suffered some serious setbacks in the Court of First Instance during 2002, where a number of the Commission's decisions were overthrown by the Courts.⁹

It is essential that the European merger control system is suitably adapted to handle these recent occurrences. The Green Paper called for opinions on how the effectiveness of the legal framework for EU merger control could be improved in order to make it more suited for facing these challenges.¹⁰ The Commission invited opinions from representatives of the business world as well as the Member States. After a year of consultation and debate on the Green Paper, a number of revision proposals followed.

The revision proposals were a result of the Commission's experience in applying the Merger Regulation for more than twelve years, and were designed to take into account the changes that had taken place during that time. For instance, the increasing number of proposed concentrations of undertakings notified to the Commission, their enhanced economic complexity and the greater levels of concentration in the current markets that have demanded superior sophistication in the economic analysis performed by the Commission in its merger assessments.¹¹ The proposed renovation was also aimed at amending alleged weaknesses that had surfaced over time.

The reform pursued the twofold objective of:

- consolidating the successful features of the EU merger control system, particularly the tight deadlines and the transparency of the merger assessments;
- ensuring that the Merger Regulations continues to be an effective tool of merger control in an internationally globalising business environment and in an enlarged Community with increasing levels of market and monetary integration.¹²

Community regulations regularly go through reviews of their respective provisions in order to keep them updated and in phase with the current relevant developments. The Merger Regulation foresaw such a regular

⁹ Case T-342/99 *Airtours v Commission*; Case T-310/01 *Schneider v Commission*, judgment of the Court of First Instance of October 22, 2002, ECR-II 4071, annulling Commission decision COMP/M. 2283 *Schneider/Legrand*, October 10, 2001; Case T-5/02 *Tetra Laval v Commission*, judgment of the Court of First Instance of October 24, 2002, [2002] 5 C.M.L.R. 28, annulling Commission decision DG/COMP/M.2416 *Tetra Laval/Sidel*, October 30, 2001; Case T-251/00 *Lagardère v Commission*.

¹⁰ Papaioannou, Anna; Diez, Ulrich; Ryan, Stephen and Sjöblom, Dan, "Green Paper on the review of the Merger Regulation", Competition Policy Newsletter No 1, Brussels 2002, p. 65

¹¹ Ryan, Stephen A., "Reform of the EU Merger Control System-a comprehensive package of proposals", Competition Policy Newsletter No 1, Brussels 2003, p. 9

¹² Papaioannou, Anna; Diez, Ulrich; Ryan, Stephen and Sjöblom, Dan, p. 65

review concerning the scope of the Commission's competence in merger control, but the review presented the Commission with a possibility to go beyond mere adjustments and make a more comprehensive and progressive investigation of the performance of the Merger Regulation altogether.¹³

2.3 Results of the reform

The procedural changes that were introduced in the 2004 Merger Regulation most certainly have a great significance for the daily routine in handling merger control cases in Brussels, they will however not be further touched upon here as this falls outside the scope of the thesis.

2.3.1 The creation of a new substantive test

A landmark change resulting from the reform of EU merger control is the rewording of the substantive test for the assessment of mergers. The substantive test is the backbone of the Merger Regulation due to the fact that it has to be followed by the Commission in its merger appraisals.

The most significant concept in EU merger control has previously been the creation or strengthening of a dominant position on the relevant market-/-s. One of the reasons for not completely transforming the substantive test was that the massive amounts of case-law and experience that had been gathered during the years would then be wasted and overthrown. This was not something that was considered desirable or economically efficient. And although the focus has shifted in light of the recent developments, dominance still holds a very significant importance to current Community merger control, as a lot of the mergers notified to the Commission are still evaluated with the concept of dominance ever present.

Subsequently a presentation of the concept of dominance will follow in order to fully appreciate the shift in significance that the reform has presented.

2.3.1.1 Dominance

As mentioned above, the old substantive test in Regulation 4064/89 was based on the notion of dominance:

“A concentration which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it shall be declared incompatible with the common market.”¹⁴

¹³ Papaioannou, Anna; Diez, Ulrich; Ryan, Stephen and Sjöblom, Dan, p. 65

¹⁴ The former Merger Regulation, Art. 2(3)

There were two successive branches, or tiers, to the substantive test utilised by the Commission in order to establish whether a concentration may be deemed as compatible with the common market. The first was whether the concentration created or strengthened a dominant position.

Although the substantive test has changed, the concept of dominance is still relevant.

When evaluating the relevant market characteristics, the commission has to establish a causal link between the concentration and the creation or strengthening of a dominant position. If no such link can be established, the concentration must be approved without obligation or conditions. As a consequence, there must also be a causal link between the markets affected by the proposed merger. The reason for this is that the Commission must not run the risk of prohibiting a concentration between a company that enjoys near monopoly power in one product market and another undertaking that has a very high share of another market without being dominant, if there is no significant overlap in the two product markets.

According to article 2(3) of the Merger Regulation, a concentration that creates or strengthens a dominant position as a result of which effective competition within the common market or at least in a substantial part of it would be significantly impeded is to be declared incompatible with the common market. Consequently any proposed concentration that does not impede competition in that manner should be allowed to proceed. The Commission does not actually examine whether or not the dominant position significantly impedes competition.¹⁵

The concept of “dominant position” in article 2(3) has been interpreted by the European Court of Justice as:

“a position of economic strength enjoyed by the undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately consumers”.¹⁶

and:

“such a position does not preclude some competition, which it does where there is a monopoly or quasi-monopoly, but enables the undertaking which profits by it, if not to determine, at least to have an appreciable influence on the

¹⁵ Verloop, Peter (ed. Dutilh, Nauta), ”Merger Control in the EU: a survey of European Competition Laws”, 3rd Edition, The Hague: Kluwer Law International, 1999, p. 22

¹⁶ Case 27/76 *United Brands Co. and United Brands Continental BV v. European Commission* [1978] E.C.R. 207; [1978] 1 C.M.L.R. 429

conditions under which that competition will develop, and in any case to act largely in disregard of it so long as such conduct does not operate to its detriment.”¹⁷

In other words, according to the Court of Justice, an undertaking is to be considered dominant if it has the power to operate to an appreciable extent independently of its competitors, customers and ultimately of its consumers. On the other hand, a dominant position is not as strong as a monopoly or quasi-monopoly. It is sufficient that a company has an appreciable influence on the conditions of a market that allows it to act essentially in disregard of the competition at hand.¹⁸ This definition is a legal and not an economic concept. However, the assessment of the effects of a proposed merger on competition has to be an economic analysis with focus on the latent enhancement of market power resulting from the merger, and the legal definition of dominance is very close to the economic notion of market power.¹⁹ Hence, the most important question to be answered in the dominance assessment is whether the notified merger increases the merging parties’ market power so substantially that they are able to “act to an appreciable extent independently of their competitors, customers and ultimately of consumers”.²⁰

One of the most obvious indicators of dominance is the degree of market share acquired as a result of the merger. It is provided in the preamble of the Merger Regulation that a concentration between or amongst undertakings with a combined market share of less than 25% may be presumed to be compatible with the common market. However, this threshold is only a presumption and has not been incorporated into the body of the Merger Regulation.

Concentrations that produce control of a higher market share – as high as 80% - have been deemed to be compatible with the common market when taking other criteria into consideration.²¹ An example of this is the presence of barriers to entry into the markets concerned. If the barriers to entry are sufficiently high, the actors on a market may be able to place themselves in a position of “gate keeper”²² to the market and thus preventing other potential competitors from entering the market at hand. A concentration that creates a dominant position is not incompatible with the common market if there is strong evidence that the dominance is impermanent and that it is likely to erode as a result of a high probability that competitors will soon be entering the market.²³

¹⁷ Case 85/76 *Hoffman-La Roche & Co AG v. Commission* [1979] ECR 461.

¹⁸ Faull, Jonathan; Nikpay, Ali, “The EC Law of Competition”, Oxford: Oxford University Press, 1999, p. 241

¹⁹ Röller, Lars-Hendrik; de la Mano, Miguel, “The impact of the New Substantive Test in European Merger Control”, European Commission, 2006, p. 5

²⁰ Faull, Jonathan; Nikpay, Ali, p. 242

²¹ Decision 91/251 *Alcatel/Telettra* O.J. L122/48

²² Faull, Jonathan; Nikpay, Ali, p. 242

²³ Lane, Robert, p. 267

In the merger analysis, the Commission has to consider the future development of the market in question as well as the expected changes of the competition structures resulting from the merger. One of the concerns taken account of is whether the merged entity will be able to raise prices. But the Commission's assessment goes beyond just changes in price levels and also considers the merged entities' possibilities to discriminate unjustly or restrict production without suffering any consequences or in a way that would not be possible on a competitively efficient market.²⁴

The problems with high barriers to entry and dominance lie not merely in the potential for the undertakings to earn monopoly profits by charging its customers higher prices, but also with the negative impact on consumer choice. The selection, from which customers may choose, is at a risk of being reduced over a period of time if outside potential competitors are effectively hindered to enter the relevant market by the dominant firms already active in it.

Other concerns that should be considered in the Commission's dominance assessment is the potential increase in scope for predatory pricing²⁵ or the latent negative effects resulting from dominant firms' refusals to deliver to third parties.²⁶

Other factors to be considered include the existence of effective competition from outside the Community, alternative (but not necessarily directly substitutable) products, and a general restructuring of the market.²⁷

2.3.1.2 The SIEC test

Under the dominance test, the Commission was – strictly speaking - not able to contest mergers with an anti-competitive effect if they did not create or strengthen a dominant position.²⁸ This gap was one of the circumstances which launched the debate by the Commission in the Green Paper on the virtues of the substantive test in article 2 of Regulation 4064/89 and particularly how the effectiveness of the test compared with the SLC (Substantial Lessening of Competition) test as applied in other jurisdictions, notably the U.S. but also in the U.K., Ireland, Canada and Australia.²⁹

²⁴ Bos, P. V. F.; Stuyck, P.; Wytinck, P., "Concentration Control in the European Economic Community", London: Graham & Trotham, 1992, p. 234

²⁵ I.e. the possibility for dominant firms to decrease their prices thus attracting more customers to the detriment of weaker companies that may find themselves pushed out of business as a result of the dominant firm's ability to maintain its lower prices until the non-dominant firm leaves the market or goes bankrupt.

²⁶ Faull, Jonathan; Nikpay, Ali, p. 242

²⁷ Lane, Robert, p. 267

²⁸ Maudhuit, Sylvie; Soames, Trevor, "Changes in EU Merger Control Part: 2", European Competition Law Review, [2005], Issue 2, p. 75

²⁹ A further look into the SLC test will be presented later on in this thesis under heading "The SLC test (Significant Lessening of Competition)" 4.5.1.2.

It was also debated whether a change should be recommended to substitute the EC substantive test with the SLC test. The consultation period resulted in a large number of commentaries being submitted, pleading both for and against such a change. A large portion of the submitted comments encouraging a substitution stated that the SLC test would be essentially better suited to handle the complexity of competition concerns that mergers can bring about.³⁰

In spite of this critique, the Commission came to the conclusion that the possible disadvantages of the preservation of the substantive test were exaggerated and that the EC and the U.S. methods for assessing proposed concentrations have produced essentially convergent results. The Commission also did not wish to overthrow the long-standing practice both from the Courts and from the Commission. So, with the intention of ensuring legal certainty and improving transparency about the scope of the current substantive test, the Commission suggested a clarification of the concept of dominance. The clarification was to be incorporated into the text of article 2 of the Merger Regulation by adding an extra paragraph to the article and also by adding further recitals to the Regulation.

The debate resulted in a rewording of the substantive test in the Merger Regulation to make sure that all anti-competitive mergers resulting in increased price-levels, reduced output, less diversity or innovation could also be covered:

“A concentration which would significantly impede effective competition, in the common market or in a substantial part of it, in particular by the creation or strengthening of a dominant position, shall be declared incompatible with the common market.”³¹

By the introduction of this SIEC (Significant Impediment to Effective Competition) test, the Council hoped to bring in an increased level of flexibility while still preserving the concept of dominance.³² Dominance is now to be seen as an example of anti-competitive effects of a merger alongside other such effects.

The reason for adding this clarification was to make it clear that the substantive test does indeed apply when mergers result in unilateral effects in situations of oligopoly, which is one of the gaps that some commentators pointed out.³³ Indeed, a desired effect of the new wording of the substantive test is that all post-merger scenarios that pose a threat to competition, including oligopolies, are now covered by the test.³⁴

³⁰ Ryan, Stephen A., p. 9

³¹ Regulation 139/2004 Art. 2(3)

³² Maudhuit, Sylvie; Soames, Trevor, 2005, p. 76

³³ This topic will be further dealt with below under heading “Dominance vs SIEC”.

³⁴ Ibid. p. 76

The clarification is to be consistent with the definition of dominance as described by the Court of Justice in the *Gencor v. the Commission* case,³⁵ but it is intended to focus more directly on the dynamic effects of mergers.

The change was, as mentioned above, aimed at increasing the levels of clarity and transparency with regards to the application by the Commission of the substantive test. This desired clarity can, if achieved, be said to have a value in itself and may also carry a certain amount of economic effect.³⁶ This economic effect can occur because when presenting undertakings in the process of entering into a merger agreement with a clear and comprehensible test, the antitrust agency gains a signalling as well as a reputation effect throughout the relevant market.³⁷ What this means is that companies that are entertaining the idea of entering into a merger agreement are much more likely to make an economically sound decision on the matter, if they can readily assess the possibilities of succeeding in this venture. If it is clear that the merger would be prohibited, the merger would not even be attempted, thus preventing inefficient use of effort and capital on both the undertakings and the antitrust agency's part.

2.3.1.3 Dominance vs SIEC

When comparing the two substantive tests, it becomes rather obvious that the dominance test had some limitations.

The original substantive test consisted of an assessment of whether dominance would be created or strengthened resulting in a significant impediment to effective competition. This test thus demanded both created or strengthened dominance and SIEC as a result of the merger. In the new substantive test SIEC is the pillar and dominance is merely a prime instance of SIEC. This shift means that it is now interesting to assess how a proposed merger affects competition in general, not whether the merger passes a threshold of dominance.³⁸ This transference towards a more effects-based approach to merger assessments will probably lead to an increased level of importance being assigned to more dynamic market evaluation concepts, such as efficiencies.

Another aspect where the old dominance test came up short is that of unilateral or non-coordinated effects. A number of recent mergers occur in markets that show a significant level of concentration even before the merger. If the merger creates a market leader, the test for single firm

³⁵ Case T-102/96 *Gencor/Commission*, [1999] ECR II-753, para. 200. "The dominant position referred to is concerned with a situation where one or more undertakings wield 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 considerable extent independently of their competitors, their customers and, ultimately, of consumers."

³⁶ Röller, Lars-Hendrik; de la Mano, Miguel, 2006, p. 8

³⁷ *Ibid.* p. 8

³⁸ Vickers, John, "Merger Policy in Europe: Retrospect and Prospect", *European Competition Law Review*, [2004], Issue 7, p. 455

dominance will be suitable, but if the merger reduces the number of competitors but does not create a new market leader, the level of competition will still be diminished. And the only way to tackle this matter under the old dominance test was to find out if a group of undertakings - that the merging parties belong to – may be considered to hold a position of joint dominance.³⁹

This glitch in the dominance test was pointed out in the *Airtours* judgment of the Court of First Instance.⁴⁰ In accordance with the line of reasoning presented in the case, a position of joint dominance will only be considered to exist where there are co-ordinated effects, which means that the merger at hand results in a market structure where it is likely that the major market actors will resort to (tacit) co-ordination, i.e. that they are able and perhaps even given the incentive to act in consent instead of competing with one another.⁴¹ Several commentators drew the conclusion from the *Airtours* case that non-coordinated, or unilateral, effects from a merger could not be caught by the old substantive test in Regulation 4064/89 in the absence of joint dominance as defined in the case.⁴² This presented a gap that needed to be filled.⁴³

Presently, the creation or strengthening of a dominant position is secondary to the primary test of whether the proposed merger is a significant impediment to effective competition. In Recital 25 of the Merger Regulation, it is indicated specifically that one function of the new substantive test is to close that very gap, and hence make sure that even non-coordinated effects of a merger may be considered in the merger assessments currently being executed as opposed to the old dominance test.⁴⁴

When comparing the scope of the old and new substantive test it can be concluded that:

- The new test is an effects based competition test that puts focus on the concerns that are essential to an assessment of the impact on competition of concentrations;
- The new test should be better equipped to handle all possible anti-competitive post-merger scenarios due to its higher level of flexibility and lack of a “legal straightjacket” that the requirement of dominance put on merger assessments under Regulation 4064/89;

³⁹ Weitbrecht, Andreas, "EU Merger Control in 2004 – An Overview", European Competition Law Review, [2005], Issue 2, p. 67

⁴⁰ Case T-342/99 *Airtours v Commission*, judgment of the Court of First Instance of June 6, 2005, [2002] E.C.R. II-2585; [2002] 5 C.M.L.R. 7, annulling Commission decision CD/COMP/M.1524 *Airtours/First Choice*, September 22, 1999

⁴¹ Weitbrecht, Andreas, 2004, p. 68

⁴² *Ibid.* p. 68

⁴³ Apparently the Commission has not acknowledged the existence of such a gap, but has nevertheless made efforts to fill it.

⁴⁴ Weitbrecht, Andreas, 2004, p. 68

- The new test preserves continuity by making sure that the case law and practise under the dominance test is not completely overthrown;
- The new test will be applied on the basis of comprehensive guidelines, also heavily influenced by the demand for more modern, flexible and effects based assessments;
- The new test will to a higher extent than the dominance test, contribute to international convergence in merger control appraisal standards.⁴⁵

The new test calls for an awareness of the competitive effects of the proposed merger, and even though the Commission had gradually adopted an effects-based approach under the old substantive test, the SIEC test has solidified this trend.

2.3.2 Recital 29

Of interest to this thesis is also the addition of recital 29 to the Merger Regulation. With the adoption of recital 29, efficiencies are now explicitly mentioned as a defence to mergers that might otherwise appear problematic:

“In order to determine the impact of a concentration on competition in the common market, it is appropriate to take account of any substantiated and likely efficiencies put forward by the undertakings concerned. It is possible that the efficiencies brought about by the concentration counteract the effects on competition, and in particular the potential harm to consumers, that it might otherwise have and that, as a consequence, the concentration would not 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. The Commission should publish guidance on the conditions under which it may take efficiencies into account in the assessment of a concentration”.⁴⁶

The Commission has adopted Horizontal Mergers Guidelines that explore the way to apply this test in future cases.

2.3.3 The Horizontal Mergers Guidelines

In an effort to enhance the level of legal certainty in the merger control assessment, the Commission has adopted Guidelines on the Assessment of

⁴⁵ Fountoukakos, Kyriakos; Ryan, Stephen, "A New Substantive Test for EU Merger Control", *European Competition Law Review*, [2005], Issue 5, p. 288

⁴⁶ Regulation 139/2004 Recital 29

Horizontal mergers, and it intends to adopt further Notices on recommended practise when assessing vertical and conglomerate mergers.⁴⁷

Horizontal mergers arise when the merging undertakings are actual or potential competitors on the same relevant market.⁴⁸

The Guidelines regarding horizontal mergers specifies two basic ways that horizontal mergers may raise competitive concerns in particular by creating or strengthening a dominant position:

- by eliminating important competitive constraints on one or more firms, which consequently would have increased market power, without resorting to coordinated behaviour (non-coordinated effects);
- by changing the nature of competition in such a way that firms that previously were not coordinating their behaviour, are now significantly more likely to coordinate and raise prices or otherwise harm effective competition. A merger may also make coordination easier, more stable or more effective for firms which were coordinating prior to the merger (coordinated effects).⁴⁹

Furthermore, the Guidelines also handle specific factors that may be capable of overthrowing a preliminary finding of anti-competitiveness in a proposed merger. These factors include buyer power⁵⁰, easy access to the relevant market by potential competitors not yet present in it⁵¹, the fact that the merger may be the sole alternative left for the acquired firm apart from leaving the market⁵² and finally efficiency gains.⁵³

It is stated in the Guidelines that merger specific efficiencies should be considered by the Commission in its overall assessment of concentrations.⁵⁴ Consequentially, established efficiencies may now be assigned enough weight to tilt the substantive test towards a competitive assessment resulting in a favourable outcome for the parties of the proposed concentration, thus allowing the merger to proceed.

After acknowledging the role of efficiencies in competitive assessments, the Commission retreats by cautioning that efficiency claims may only be considered when it is possible for the Commission to be sufficiently

⁴⁷ Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, [2004] O.J. C-31/5.

⁴⁸ Maudhuit, Sylvie; Soames, Trevor, 2005, p. 77

⁴⁹ The Guidelines para. 22

⁵⁰ Quite simplified, buyer power can be said to exist in a market if the consumers in it are powerful enough to have an affect on price levels, through their purchasing behaviour or otherwise. The Guidelines para. 64

⁵¹ Low barriers of market entry. The Guidelines para. 68

⁵² The Guidelines para. 89

⁵³ The Guidelines para. 76

⁵⁴ The Guidelines para. 76

confident that the efficiencies originating from the merger will actually increase the incentive of the merged entity to act in a pro-competitive manner to the benefit of consumers. The efficiencies should outweigh any unfavourable effects on consumer welfare, or at least make such effects unlikely to occur. Here the Commission explicitly states the underlying welfare standard chosen for Community merger control.⁵⁵ In order to reach the conclusion that the adverse effects of the proposed merger are indeed overcome by the efficiency gains, the efficiencies would have to be of direct benefit of the consumers, merger-specific⁵⁶, sufficiently substantial, timely and verifiable.⁵⁷

The longer efficiencies are projected into the future, the less weight the Commission may assign to the expected efficiencies. It is also essential that the Commission is able to evaluate whether the efficiencies are substantial enough to outweigh a merger's potential harm on consumer welfare. For this reason, the claimed efficiency gains should be quantified when reasonably possible. The Guidelines offer an explanation how efficiencies are evaluated in a merger investigation and also what types of efficiencies are more likely to have an effect on the outcome of the merger assessment at hand. Reductions in variable or marginal costs are stated to be more relevant to the merger analysis than reductions in fixed costs.⁵⁸ Furthermore, ascertainable efficiencies that are likely to lead to new or improved products that directly benefit consumers, are more likely to be considered by the Commission than sheer assertions to this effect.⁵⁹

The burden of proof lies with the merging parties, including the burden of proving that the efficiencies presented are indeed significant enough to offset the anti-competitive effects of the proposed merger.⁶⁰ The Commission also signifies that it is highly unlikely that efficiencies would ever be considered sufficient to clear a merger leading to the creation of a monopolistic market situation.⁶¹

2.3.4 Non-legislative measures

In order to enhance the economic abilities of the Competition Directorates, the Commission has established a new position of Chief Competition Economist within the Competition Directorate General. The person chosen for this new position has the task of providing an economic viewpoint to the decision-making process in merger cases combined with the task of offering

⁵⁵ A further discussion on the subject of welfare standards can be found below under heading "Efficiency and consumers" 4.3.

⁵⁶ Could not be achieved in any other way than through the proposed merger.

⁵⁷ The Guidelines para. 79

⁵⁸ The Guidelines para. 80

⁵⁹ The Guidelines para. 81

⁶⁰ The Guidelines para. 87

⁶¹ The Guidelines para. 84

guidance to the Commission's investigative staff.⁶² The Chief Economist is provided with the staff necessary to supply an independent economic perspective to future merger assessments.⁶³

The Commission also intends to promptly recruit industrial economists to the Directorate General, and also utilise outside economic expertise to a greater extent. A more frequent use of independent econometric studies in Phase II investigations is also predicted.⁶⁴

2.3.5 Concluding remarks

The Merger Regulation and the Horizontal Mergers Guidelines were designed to enhance the Commission's merger assessment instruments and to increase its degree of economic sophistication.⁶⁵ The Guidelines recognize that the merger assessments ought to go beyond the calculation of market shares and explicitly allow the efficiencies created by the mergers to be taken into account.⁶⁶

The changes could perhaps be perceived as a Community step towards a more dynamic economic approach in merger assessments, resulting in an increased interest in efficiency gains resulting from cross-border mergers. It could also be interpreted as a necessary and inevitable adjustment to the increasing importance of economics in current merger transactions.

⁶² Commission Press Release IP/02/1856.

⁶³ Ryan, Stephen A., p. 12

⁶⁴ Ryan, Stephen A., p. 12

⁶⁵ Kokkoris, Ioannis, "The Reform of the European Merger Control Regulation in the Aftermath of the *Airtours* case – the Eagerly Expected Debate: SLC v Dominance Test", *European Competition Law Review*, [2005], Issue 1, p. 37

⁶⁶ Kokkoris, Ioannis, p. 47

3 Essential cases

3.1 Defences

In some proposed merger cases the Commission's assessment of a concentration is not terminated by its finding that the concentration gives rise to a significant impediment on effective competition. The merging parties may in fact raise defensive arguments to justify their proposed concentration.

3.1.1 Efficiency defence: past and present

In accordance with article 2(1)(b), the Commission is required to take into account the development of technical and economic progress to the consumers' advantage provided that it does not form an obstacle to competition. This so-called efficiency defence has however not as yet been particularly successful.⁶⁷

The first decision declaring a concentration incompatible with the common market was *Aérospatiale-Alenia/De Havilland*.⁶⁸ But it did mention the possibility for efficiencies to have some importance in merger assessments.

The decision discredited the French and Italian governments for not taking into account industrial policy and employment considerations in a region of high unemployment when assessing the proposed merger of the concerned parties. The Commission showed a certain level of flexibility in the case. After establishing the existence of a dominant position the Commission went on to state that:

“In general terms, a concentration which leads to the creation of a dominant position may however be compatible with the common market within the meaning of Article 2(2) of the Merger Regulation if there exists strong evidence that this position is only temporary and would be quickly eroded because of high probability of strong market entry. With such market entry the dominant position is not likely to impede effective competition within the meaning of Article 2(3) of the Merger Regulation.”⁶⁹

The decision was a controversial one and caused differences of opinion within the Commission. The relevance of the case to this thesis lies in that it

⁶⁷ Verloop, Peter (ed.), p. 27

⁶⁸ Decision 91/619 *Aérospatiale-Alenia/De Havilland* O.J. 1991 L334/42

⁶⁹ Hildebrand, Doris, "The Role of Economic Analysis in the EC Competition Rules: The European School", The Hague: Kluwer Law International, 2002, p. 79

represents a clash between competition concerns and industrial policy, thus demonstrating the differing attitudes towards efficiencies in the form of synergies.

The parties of the case presented an approximation of cost savings coming to 0,5% of the parties' combined turnover. The causes of the cost savings were potentially obtainable synergies in marketing and product support, as well as rationalising the undertakings' procurement of parts.⁷⁰ The Commission regarded the efficiencies as "negligible" and they were considered irrelevant to the final prohibition decision. However, the efficiency gains presented were dismissed because they were small, not because they were irrelevant.⁷¹

As a response to *Aérospatiale-Alenia/De Havilland* the European Parliament adopted a resolution providing that the Merger Regulation be amended to compel the Commission to take into account the expected industrial, social, regional and environmental consequences of a proposed concentration. Although the Court of First Instance has stated that, while it is to be primarily concerned with questions of competition, that should not stop the Commission from taking into account the social effects of a concentration, provided that it is likely to affect the social objectives referred to in article 2 of the EC Treaty and liable to have consequences, even if only indirectly, upon the level or conditions of employment within the Community or a significant part of it.⁷² This may be seen as a possible loosening of the attitude against allowing factors that are not specifically competition-based to be taken into account in the concentration assessment.

Increases in efficiency and cost-savings due to restructuring have been the background to several notified concentrations. However, those kinds of benefits have been accepted under article 81(3) as economic progress capable of benefiting consumers. But unless the need for restructuring is so critical that one of the undertakings concerned may fail if the notified concentration is not allowed, there seems to have been little scope for such benefits to be taken into consideration in the Commission's assessment process.⁷³ However, a well-proved case explaining the need for restructuring might persuade the Commission to give the concerned undertakings the benefit of the doubt or at least to feel disposed to accept remedial undertakings enabling the transaction to proceed rather than issue an outright prohibition decision.⁷⁴

The Commission's compatibility-assessment should be completed in the context of the overall objectives of the Community. Hence, if it can be established f. ex. that a Community industry needs restructuring if it is to

⁷⁰ Neven, Damien; Nuttall, Robin; Seabright, Paul, p. 116

⁷¹ Neven, Damien; Nuttall, Robin; Seabright, Paul, p.63

⁷² Lane, Robert, p. 268

⁷³ This "Failing firm defence" will not be further dealt with in this thesis.

⁷⁴ Cook, C.J.; Kerse, C.S., "E.C. Merger Control", 3rd Edition, London: Sweet & Maxwell, 2000, p. 175

achieve the profitability and efficiency it needs for continued investment in research and development, the notifying parties will have created a climate which allows the notified operation to be viewed in a positive way.⁷⁵ It may give the notifying parties the benefit of the doubt where there is a conflict of evidence, or where predictions have to be made about the future. And by presenting a positive commercial justification for the notified concentration, the merging parties will also be able to prove that they had no anti-competitive or market-dominating intent.⁷⁶ It therefore comes as no surprise to find that the Commission requires such information from the notifying parties. For example, in *DuPont/ICI*⁷⁷ and *Shell/Montecatini*⁷⁸, the recognised need to restructure the EC industry may have influenced the conditional clearances.

By contrast, recognition that rationalisation can be pro-competitive did not prevent the absolute prohibition in the *Nordic Satellite Distribution* case.⁷⁹

The Commission appears to be more lenient towards concentrations that are likely to cause:

- i) efficiencies that are predicted to entice competitors to respond fiercely to the transaction performed by the merging parties;
- ii) efficiencies that may be assimilated by competitors through imitation without too substantial efforts, such as technological innovations;
- iii) efficiencies and pro-competitive effects in markets not affected directly by the proposed merger.⁸⁰

Most developed merger control systems do admit an efficiency defence, and logically such a defence should also be available within the Community. Nonetheless regulators have been sceptical about claimed efficiencies, particularly if other competitors are insufficiently effective to ensure that consumers will share the benefits.

In 1999, the Commission stated that:

“the creation of a dominant position in the relevant markets [...] means that the efficiencies argument put forward by the parties cannot be taken into account in the assessment of the present merger”.⁸¹

This standpoint reiterated the Commission’s position taken in 1996 that:

⁷⁵ Cook, C.J.; Kerse, C.S., p. 176

⁷⁶ Cook, C.J.; Kerse, C.S., p. 175

⁷⁷ Case No IV/M.984 *DuPont/ICI* [1998] O.J. C.004 08/01/1998, p. 004

⁷⁸ Case No IV/M.269 *Shell/Montecatini* 94/811/EC, O.J. L332 22/12/1994, p. 0048-0070

⁷⁹ Case IV/M490 (1995) *Nordic Satellite Distribution* [1996] O.J. L53/20

⁸⁰ de la Mano, p. 28

⁸¹ Case No. COMP/M. 1 313 – Danish Crown/Vestjyske Slakterier, par. 198 as presented in: Röller, Lars-Hendrik; de la Mano, Miguel, 2006, p. 9

“There is no real legal possibility of justifying an efficiency defence under the Merger Regulation. Efficiencies are assumed for all mergers up to the limit of dominance – the ‘concentration privilege.’ Any efficiency issues are considered in the overall assessment to determine whether dominance has been created or strengthened and not to justify or mitigate that dominance in order to clear a concentration which would otherwise be prohibited”.⁸²

A reason for this cautious approach might be the inherent difficulties that lie in predicting the future behaviour of markets and the undertakings operating in them.

This cautious attitude towards the position of efficiencies in Community Merger control has however shifted over the years. This gliding scale of acceptance has manifested itself in particular through the adoption of the new substantive test, recital 29 and the Horizontal Mergers Guidelines, as described above. This adoption explicitly validates the importance of efficiency gains as one of the basic advantages of mergers, and also clarifies to what extent such efficiencies can be utilised to offset anti-competitive effects.

In the *Air France/KLM*⁸³ case the Commission was faced with the most considerable airline merger in Europe to date.⁸⁴ The Commission came to the conclusion that that the proposed merger would eliminate or significantly reduce competition on 14 domestic and international routes. The merger was cleared by the Commission after an extensive and intricate package of commitments was presented to the parties.⁸⁵ In its press release regarding this case, the Commission acknowledged that it received the merger as being part of a necessary consolidation of European Airlines.⁸⁶ The press release also emphasized the advantages gained by passengers from cost savings, increase in the number of destinations and better connections. This emphasis seems to indicate that the Commission considered the efficiencies resulting from the merger, even if it was not specifically mentioned in the clearance decision.

Another case where efficiencies were acknowledged is the *Proctor & Gamble/Gillette* case.⁸⁷ The Commission cleared the proposed acquisition

⁸² “European Commission: Contribution to Efficiency Claims in Mergers and Other Horizontal Agreements, O.E.C.D./GD (96)65, 1996 as presented in: Röller, Lars-Hendrik; de la Mano, Miguel, 2006, p. 9

⁸³ Commission decision of February 11, 2004, Case IV/M. 3280, *Air France/KLM*

⁸⁴ Weitbrecht, Andreas, 2004, p. 70

⁸⁵ A summary of these commitments are presented in para. 157 and onwards.

⁸⁶ Press release of February 11, 2004, IP/04/194 available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/04/194> Webpage visited in 2006-06-01

⁸⁷ Case No COMP/M.3732 *Proctor&Gamble/Gillette* of July 15, 2005

of Gillette by Proctor & Gamble in Phase I, subject to the divestiture of part of Proctor & Gambles business concerning electric toothbrushes. The merger will create one of the world's most considerable producers of consumer goods. The combined turnover is estimated at around € 50 billion.⁸⁸ In this case the Commission recognized that:

“enlarging the product portfolio might bring efficiencies to retailers and customers, for example benefits from having only one partner to negotiate with (.one-stop-shop.), suppliers having stronger innovation capacities, and economies of scale and scope”.⁸⁹

The investigation conducted in the case focused on the likelihood that products of other competitors could be unjustly excluded from the market thus damaging end consumers. The Commission also investigated possible obstructions of effective competition arising in the bundling of products, rebates and promotions.⁹⁰

However, the Commission came to the conclusion that even after the merger, the merging undertakings would still be facing a significant level of competition from other suppliers on the relevant market and so countervailing buyer power, rather than efficiency effects tilted the balance against portfolio effects.

There are certain circumstances under which a positive impact resulting from technological and economic progress can be recognised, f. ex. if the Commission has identified some co-ordination effects that would be achieved by allowing a proposed merger, provided that the positive co-ordination effects will have a significant impact on competition. The effects would then be assessed under the criteria in article 2 of the Merger Regulation and might then possibly be recognised as grounds for a decision of compatibility. Another situation where co-ordination effects may be given some influence over the outcome of a proposed merger is in potentially oligopolistic markets. In such markets, the technological and efficiency benefits of a merger may be relevant because of its ability to create a catalyst to competition and disturb the stability and symmetry of existing market conditions.⁹¹ Finally, the Commission is likely to be influenced by the concept of “technology markets”, which is something that is being progressively more recognised by U.S. regulators.⁹² In these so-called “technology markets” the interest in preserving and enhancing research and development resources and skills is accentuated in a vigorous and dynamic context rather than the more static focus on the end-product, which can be identified in the assessments of other markets.

⁸⁸ Weitbrecht, Andreas, “EU Merger Control in 2005 – An Overview”, European Competition Law Review, [2006], Issue 2, p. 45

⁸⁹ Case No COMP/M.3732 Proctor&Gamble/Gillette, para. 131

⁹⁰ Weitbrecht, Andreas, 2006, p. 48

⁹¹ Cook, C.J.; Kerse, C.S., p. 177

⁹² Cook, C.J.; Kerse, C.S., p. 178

And what about inefficient companies? The disappearance of an inefficient company from the market can be seen as a normal part of the discovery process of competition, which only develops its positive effects when it can progress undisturbed and intervention-free. In other words: when evaluating the effects of a proposed merger the Commission should take into account the status of the financially weaker undertaking about to be acquired by another company. If the acquired company is financially weaker due to its own inefficient management that could be replaced through a merger, then perhaps the merging parties should be given the go-ahead to proceed with their merger plans and consequently improve the efficiency level of their respective markets.

3.1.2 Efficiency offence?

The *G.E./Honeywell* case brings to life a discussion previously held within the Community regarding the possible existence of an efficiency offence, indicating that mergers creating too efficient merged entities are likely to be prohibited as a result of this.⁹³

The existence of such an efficiency offence was, however strenuously denied by Mr Mario Monti, who is a European Competition Commissioner, in a speech from 2002.⁹⁴

3.1.2.1 The facts of the *G.E./Honeywell* case

On October 22, 2000, the acquisition of American-based avionics company Honeywell by G.E. was announced and on November 15 that same year, it was notified to the U.S. competition authorities. The concentration was notified to the European Commission on February 6, 2001.⁹⁵

G.E. is a major supplier of large aircraft engines with a market share of approximately 50%, and Honeywell supplies avionics⁹⁶ and other components for commercial aircraft, as well as small jet engines. This merger concerned two very large companies: their combined world-wide turnover was 180 billion Euro. And although both companies are U.S.-based, they both have very high European turnover: G.E. 23 billion Euro and Honeywell 6 billion Euro, so the competence of the Commission to

⁹³ Korah, Valentine, p. 352

⁹⁴ Speech made by Mr. Mario Monti European Competition Commissioner, "Review of the EC Merger Regulation-Roadmap for the reform project", in a Conference on Reform of European Merger Control with the British Chamber of Commerce in Brussels, June 4, 2002. Available at http://www.europa.eu.int/comm/competition/speeches/index_2002.html

⁹⁵ Burnside, Alec, "GE, Honey, I Sunk the Merger", European Competition Law Report, [2002] Issue 2, p. 107

⁹⁶ Avionics products are the range of equipment used for controlling aircraft, navigation and communication as well as assessing flying conditions. See Weitbrecht, Andreas, "E.U. Merger Control in 2001-The year of Controversy", European Competition Law Report, [2002] Issue 8, p. 408, note 14

handle the merger case assessment was never challenged. That was not the issue of the fierce debate following the Commission's decision to prohibit the merger that had already gained the approval of the U.S. competition authorities.

The level of horizontal overlaps between the merging parties' respective businesses was not particularly high.⁹⁷ Instead, the main concerns expressed were those regarding the indirect effects of the proposed merger, i.e. effects not arising from a reduction in the number of competitors on the relevant market.⁹⁸

The two major indirect effects identified by the Commission in the case are:

- i) Conglomerate effects, particularly "mixed bundling"; and
- ii) market foreclosure⁹⁹ through "share shifting" through integration with an aircraft buyer (General Electric Capital Aviation Services-GECAS).¹⁰⁰

3.1.2.2 Conglomerate effects

Horizontal mergers often lead to rather obvious effects on competition and create foreclosure effects, but conglomerate mergers ordinarily are not considered to affect competition as their effects are realised on separate markets that are not even vertically linked through an upwards/downwards stream of commerce.¹⁰¹

Before 2001, the Commission had scarcely ever taken conglomerate effects into account in its merger assessments, save for the so-called "portfolio effects". Portfolio effects may appear where a seller distributes a selection of complementary products to customers that ordinarily buy the entire range of such products, often at the same time¹⁰², f. ex. the distribution of alcohol or soft drinks. In those markets, wholesalers normally stock a range of the products as vodka, whiskey and rum. In a market like this, if a producer widens its product portfolio, thus creating large distribution efficiencies, then that may under extraordinary circumstances lead to the creation or strengthening of a dominant position.¹⁰³

In economics, two methods of bundling may be established:

⁹⁷ Lofaro, Andrea; Ridyard, Derek, "Beyond Bork: New Economic Theories of Exclusion in Merger Cases", European Competition Law Report, [2002] Issue 3, p. 151

⁹⁸ Pflanz, Matthias; Caffarra, Cristina, "The Economics of G.E./Honeywell", European Competition Law Report, [2002] Issue 3, p. 115

⁹⁹ Keeping the concerned competitors out of the market in question, thus excluding them from the possibility of enjoying the potential profits.

¹⁰⁰ I will however not touch upon these effects, as they do not add much of importance to this thesis.

¹⁰¹ Weitbrecht, Andreas, 2001, p. 408

¹⁰² The customers are thus purchasing a range of products, a "bundle".

¹⁰³ Weitbrecht, Andreas, 2001, p. 408

- i) pure bundling, a.k.a. tying, where the products are not sold separately but only as part of a “bundle”. An example of this is products that are manufactured so that they can not be physically separated, or will not function properly if they are utilised in combination with the competitors’ products; and
- ii) mixed bundling where the products are available for sale separately, but at the same time are offered as a package on discounted terms.

In *G.E./Honeywell*, the Commission’s focus was on the second of the bundling methods.¹⁰⁴ The Commission was concerned that after the merger, G.E. would offer package discounts to customers buying both G.E. aircraft engines and Honeywell products, thus adversely affecting the competitors’ market shares and profits and perhaps even ultimately forcing them out of business.¹⁰⁵ This effect would arise as a result of possible pricing efficiency gains in mergers of undertakings offering complementary products. The potential efficiencies would originate in the possibility of the merged entity to consider the effect that the price of one of the complementary products has on the others, thus facing an incentive to offer lower prices not available to a supplier dealing with just one product. Because engines and avionics are complementary products- they are both necessary on an aircraft- the merged entity of G.E. and Honeywell might be able to sell larger quantities of avionics if it had the possibility to price the engine more cheaply, and vice versa.

However, the central anticipated effect that was the basis for the Commission’s competitive concerns was the decrease in price levels resulting from the above-mentioned pricing efficiency. In order for this effect to be anti-competitive and ultimately cause detriment to consumer welfare, the pricing efficiencies would have to be so substantial that competing companies with narrower product range would be unable to stay in the market for a longer period of time. Consequentially, the Commission’s concerns were that the proposed merger would enable the merged entity to threaten the future of competitors by making it too efficient.¹⁰⁶ In other words, the focus was on the predicted effects of the merger on the competitors and perhaps not so much on competition.¹⁰⁷ It was never established whether the discounts offered to customers by the merged entity would in fact ever drive one or more of the market participants out of the market, it was also never established that the competitors would not be able to enjoy the advantages of the merged entity through the mimic of its behaviour.¹⁰⁸

In order for mixed bundling to cause anti-competitive results, there must be an established chance that the merged entity could actually obtain the

¹⁰⁴ Pflanz, Matthias; Caffarra, Cristina, p. 115

¹⁰⁵ This conclusion by the Commission was apparently based on a theoretical economic model provided by a competitor, see Pflanz, Matthias; Caffarra, Cristina, p. 115

¹⁰⁶ Pflanz, Matthias; Caffarra, Cristina, p. 116

¹⁰⁷ Lofaro, Andrea; Ridyard, Derek, p. 151

¹⁰⁸ Burnside, Alec, p. 108

strength necessary to force competitors to exit the concerned market. Thereafter leaving the merged entity with a possibility to raise prices, without fearing re-entry by the competitors or new entry by potential competitors not yet on the market.¹⁰⁹ If there is no such chance of unwanted merger-caused increases in market power, then selling goods together on discounted terms should perhaps simply be regarded as an efficient way to conduct business.

When applying this way of integrating pricing efficiencies into merger assessments, it is impossible to avoid the difficulties of establishing the conditions of market exit. It calls for an evaluation of the discount levels at which the competitors' market shares would be so adversely affected that they would be forced to leave the concerned market. Merger appraisals generally contain an element of predicting the future characteristics of a market after a concentration, but predicting market exit must be considered as more hazardous than predicting short-run changes in price levels resulting from a merger.

The hazardous element lies in the extended time periods involved, as it is always more difficult to assess the effects of a transaction reaching far into the future. Furthermore, it is difficult to predict the changes in general economic conditions and how the decisions of competitors will influence their position on the market, hence assuming that the competitors would not react to the challenge.¹¹⁰ It is also virtually impossible to evaluate the progression of the competitors' businesses such as the success of future products.¹¹¹ The U.S. authorities recognised these inherent difficulties and decided to assign more weight to the short-term efficiency gains than the more speculative long-term effects on the market structure. Consequentially, the U.S. authorities allowed the merger to proceed, thus causing a heated debate as to the effectiveness of Community merger control and its lack of international convergence.

3.1.2.3 The *AT&T/NCR* and *MSG/Media Service* cases

Another much debated merger case where synergies were considered is the *AT&T/NCR*¹¹² case from 1991, where the Commission considered whether AT&T's technical and marketing know-how might possibly be used in order to "enhance the position of NCR in the workstation market".¹¹³ One way that that might occur was through the "potential complementarity" between the technical know-how and the marketing of workstations that could result in synergies through the potential development of "more advanced communication features at a lower cost". The Commission eventually came to the conclusion that no such complementarity could be foreseen at that moment and the merger was allowed to proceed. Nonetheless, the

¹⁰⁹ Pflanz, Matthias; Caffarra, Cristina, p. 117

¹¹⁰ Burnside, Alec, p. 108

¹¹¹ Pflanz, Matthias; Caffarra, Cristina, p. 117

¹¹² Case No IV/M.050 *AT&T/NCR*, [1991] O.J. C.016

¹¹³ Neven, Damien; Nuttall, Robin; Seabright, Paul, p. 116

Commission did not rule out the possibility that “potential advantages flowing from synergies might create or strengthen a dominant position”. Consequently, in this case the Commission considered cost savings to be a negative factor that could potentially lead to the creation or strengthening of a dominant position.¹¹⁴

In the *AT&T/NCR* case, the Commission did state that efficiency gains resulting from a merger induced synergies may create or strengthen a dominant position, indicating that extensively substantial efficiency gains may be considered by the Commission as a reason for prohibiting a proposed concentration.

The Commission substantiated this hesitant approach to the efficiencies defence in the *MSG/Media Service* case¹¹⁵, in which a joint venture was established to operate in the field of digital pay-TV. The Commission came to the conclusion that, although MSG would contribute to the improvement and maturity of digital television, the successful spread of that medium would be hindered rather than promoted by the limiting effect on new entry which would be the result of the dominant position the joint venture would quickly gain. The Commission even questioned whether it was probable that technical and economic progress would be achieved at all. And even if such efficiencies would be gained by allowing the merger to proceed, the Commission expressed concerns that the technical and economic progress achieved by the merged enterprises might enable them to leave their competitors behind. The efficiencies gained might consequently have been something that actually contributed to the creation or reinforcement of a dominant position in this merger case.¹¹⁶

These cases do indeed, in the light of the more recent *G.E./Honeywell* case, appear to be supporting the notion that a European Community efficiency offence in merger cases has been applied. Optimistically, this efficiency offence will have been eradicated or at least diminished by the abovementioned reform of the Community merger control system.

3.2 Commitments

Merging parties may be asked to enter into commitments with the purpose of outweighing the anticipated anti-competitive effects of the proposed merger, and the parties may try to avoid a negative decision by offering commitments, or remedies, under article 6 and 8 of the Merger Regulation.

Since the reasons for a prohibition will still often result from an accumulation of market shares, the most recurrent remedy relates to an obligation to dispose of a part of the acquired market share. This kind of

¹¹⁴ Neven, Damien; Nuttall, Robin; Seabright, Paul, p. 116

¹¹⁵ Case *MSG/Media Service*, [1994] O.J. L364/1

¹¹⁶ Cook, C.J.; Kerse, C.S., p. 177

partial divestment may be achieved by selling subsidiaries, assets, trademarks, technology or shares.¹¹⁷ These types of obligations are seen as structural remedies, because they affect the number of players on the market. They correspond to one of the basic objective of concentration control, which is to preserve sound market structures. However, in a number of cases the Commission has been increasingly prepared to recognise conduct remedies that have little to do with market structure, but instead determine the market behaviour of the merged entity. The majority of the behavioural remedies accepted to date relates to the termination of distribution or technology transfer agreements. Grant of technology licenses in *DuPont/ICI*¹¹⁸ and in *Boeing/McDonnell-Douglas*¹¹⁹, conclusion of supply agreements in *Elf Aquitaine-Thyssen/Minol*¹²⁰, termination of distribution agreements in *KNP/BT/VRG*¹²¹, *Unilever France/Ortiz-Miko* and in the *Coca-Cola company/Carlsberg*¹²², termination of long term supply agreements in *Boeing/McDonnell Douglas*.¹²³

The predictions necessary to assess the future behaviour of markets and the firms in them are extremely difficult for the Commission to make. The chances of successfully challenging a legal decision are very remote, unless it is obvious that completely irrelevant considerations have been taken into account, or decidedly relevant evidence ignored.¹²⁴ Even then the outcome of the appeal will usually depend on the determination of a competitor or customer to pursue its legal remedies to the full. The final outcome may also be influenced by seemingly irrelevant factors such as the credibility of the notifying parties, the strength of complaints or customer reaction, or the evidence submitted by competitors.¹²⁵ Despite, therefore, the emphasis on competition and market structure, parties should not lose sight of the advantage to be gained by explaining fully and carefully the rationale behind the notified operation and the benefits it will achieve, particularly for consumers in the Community or EEA.¹²⁶

¹¹⁷ Verloop, Peter (ed.), p. 28

¹¹⁸ Decision 30.9.92, *Du Pont/ICI* IV/M.214

¹¹⁹ Decision 30.7.97, *Boeing/Mc Donnell-Douglas*, O.J. L 366, IV/M.877

¹²⁰ Decision *Elf Aquitaine-Thyssen/Minol* 4.9.92, IV/M.235

¹²¹ Decision *KNP/BT/VRG* 4.5.93, IV/M.291

¹²² Decision *Coca-Cola company/Carlsberg* 11.9.97, IV/M.833

¹²³ Verloop, Peter (ed.), p. 28

¹²⁴ Cook, C.J.; Kerse, C.S., p. 175

¹²⁵ Cook, C.J.; Kerse, C.S., p. 175

¹²⁶ Cook, C.J.; Kerse, C.S., p. 175

4 The specifics of efficiency

4.1 Introduction

The economic foundation to current merger control is that competition is a way to achieve efficient market results. A high level of competition is expected to lead to an increase in economic welfare by bringing about an optimal allocation of resources, by providing motivation for companies to achieve productive and organisational efficiency and by promoting technological advances and aiding the spreading of knowledge.¹²⁷ Distortions to the structure of a market (f. ex. mergers), which may significantly impede competition should therefore be supervised and if deemed necessary, prohibited.

But what if there are consequences to these potentially anti-competitive transactions that may outweigh the negative effects? Cue, efficiencies...

Mergers can produce greater economic efficiency, mainly through increase in economies of scale, but also through a higher operative efficiency, management efficiency and improved spreading of innovative technology.¹²⁸

When motivated by the concerned undertakings wish to become more efficient and competitive, mergers may actually lead to optimal resource allocation and improve the competitive performance of the affected markets.¹²⁹ When looked at from a purely Community perspective, mergers lead to integration, rationalisation of market interpenetration and a unification of the single market.¹³⁰ These are objectives that must be considered to be desirable from a Community point of view. It should be apparent that allowing mergers that have as a result the integration and unification mentioned above will lead to the basic intentions of the Community being accomplished. But when applying another perspective the outcome may not seem quite so favourable, as mergers can in some cases be said to weaken competition, since if one undertaking acquires another, this leaves the market with one less competitor.

4.2 Efficiency and market power

The concept of “competition” is closely linked to the concept of “market power”. Market power may be defined as the ability of one or more firms to

¹²⁷ de la Mano, Miguel (ed.), “For the customer’s sake: The competitive effects of efficiencies in European merger control”, Enterprise Papers No 11, Belgium 2002, p.

¹²⁸ Lane, Robert, p. 257

¹²⁹ de la Mano, Miguel (ed.), p. v

¹³⁰ Lane, Robert, p. 257

profitably maintain prices above the level corresponding to perfect competition for a significant period of time.

Economists ordinarily identify three broad classes of efficiencies that are all essential to the assessment of the competitive effects of a proposed merger:

- i) allocative efficiency that may be achieved when the existing stock of goods are allocated, by use of the pricing system, to the customers who value them the most. The value is established by determining the buyers' willingness to pay for the relevant product, or the willingness to forsake other means of consumption. At an allocatively efficient outcome, the prices on the considered market are equal to the real costs of producing and supplying the products;
- ii) productive¹³¹ efficiency is a more narrow notion when compared to allocative efficiency. Productive efficiency hones in on a specific company or industry, addressing the question of whether a particular level of output is being produced at the least cost possible. Or in other words, if the combination of inputs is producing the maximum output possible;
- iii) dynamic¹³² efficiency is connected to whether appropriate incentives and capability is present in order for productivity to increase, and innovative activities to expand over a period of time. This is what makes dynamic efficiency different from allocative and productive efficiency, that are static forms of efficiency, not considering the changes and progress on a market.¹³³

To summarize the abovementioned it may be viewed that effective competition may not be regarded to be distorted significantly when producers post-merger are continuously pushed to satisfy consumer requests at the lowest price (allocative efficiency) while using the fewest resources (productive efficiency), and thus encouraging progressiveness (dynamic efficiency).¹³⁴

The reason why market power is of importance in a merger assessment analysis is that it may lead to allocative inefficiency and it may also cause detriment to productive efficiency.¹³⁵

The presence of market power is however more a rule than an exception. When looked at from a short-term perspective, all firms will have at least some degree of market power, depending on consumer preferences and consumers' access to substitute products. As price increases, consumers are more likely to switch to the closest available substitute product or spend

¹³¹ Sometimes referred to as "technical" efficiency.

¹³² Sometimes referred to as "innovation" efficiency.

¹³³ De la Mano, Miguel (ed.), p. 8

¹³⁴ Luescher, Christoph, "Efficiency Considerations in European Merger Control – Just a Battle Ground for the European Commission, Economists and Competition Lawyers?", *European Competition Law Review*, [2004], Issue 2, p.73

¹³⁵ de la Mano, Miguel (ed.), p. 9

their money on other goods. The ability of customers to switch to other suppliers is defined as the respective undertaking's elasticity of demand.¹³⁶ In other words, whether a concentration will enable the undertaking to increase its price levels without losing customers.¹³⁷

This was described in the *Renault/Volvo* case:

“It appears therefore unlikely that Renault and Volvo will have the power to behave to an appreciable extent independently of these competitors or to gain an appreciable influence on the determination of prices without losing market shares.”¹³⁸

For this reason the extent of an undertaking's market power can be measured with reference to its elasticity of demand. In its dominance assessment, the Commission ordinarily considers whether the proposed merger would leave the merged entity in a position to increase prices or lower the levels of output if it was allowed to proceed.¹³⁹ A merger is considered to be anti-competitive and hence incompatible with the common market if it leads to a significant increase in market power resulting in price increases and a shortage of output at the expense of consumer welfare.

Information on market power can be gathered from data on market shares and the structure of the overall market concentration on the relevant market/-s being investigated.¹⁴⁰ Highly concentrated markets where competition levels are low tend to include a collectively held exercise of market power, but in a paper on the competitive effects of efficiencies in European merger control, Miguel de la Mano, a member of the Chief Economist team in DG Competition, mentions four reasons why that is not necessarily true.¹⁴¹ First, if seriously attempted entry into a market is likely, timely and sufficient, the merged entity's ability to exercise market power will be properly constrained, even if it should come to hold a large market share. Second, the current relevant market definition treats each possible substitute product as either inside or outside the market in question, not considering the constraints that undertakings selling within the same market put on each other. Third, buyers on the market may be able to exercise countervailing power restraining the sellers' ability to profitably raise their prices for a significant period of time. Fourth and finally, the reason why the undertaking has a large market share could be that it has low costs or sells products of a superior quality when compared to the other sellers on the market.

¹³⁶ de la Mano, Miguel (ed.), p. 9

¹³⁷ Hildebrand, Doris, p. 79

¹³⁸ Case M I *Renault/Volvo*, 7.11.1990 O.J. C 281/12, para. 14

¹³⁹ Faull, Jonathan; Nikpay, Ali, p. 242

¹⁴⁰ Goyder, D.G., "EC Competition Law", 3rd Edition, Oxford: Clarendon Press, 1998, p. 403

¹⁴¹ De la Mano, Miguel (ed.) p. 10

For these reasons it is, if possible, always preferable to focus on an undertaking's elasticity of demand when attempting to assess market power.¹⁴² This is probably why the specific market shares mentioned in the Preamble of the Merger Regulation are merely to be considered as benchmarks and not as written in stone.

The difficulty in utilising elasticity of demand when assessing market power in a merger investigation is that elasticity estimates are very rarely readily available and the market shares of the merged entity may be the only substitute available to show the existence of market power. For this reason, a large portion of a merger appraisal is spent analysing how accurate (or misleading) the substitutes for elasticity estimates are in each case. There are further difficulties associated with using elasticity of demand as a tool for assessing the market power of a merged entity. The conditional elasticity can not be directly observed and the post-merger elasticity of the merged entity is very likely to differ from that of the merging parties prior to the concentration.¹⁴³

4.3 Efficiency and consumers

When trying to determine the efficiency consequences of a proposed merger, the outcome is dependent on the relative weight that is given to the welfare of the various groups of market participants. The rule used when assigning such weight is called a "welfare standard".¹⁴⁴ The choice of a welfare standard indicates to the merger control authorities which standard they are supposed to maximise. The result of the efficiency appraisal will depend on which welfare standard was applied. A merger policy that was designed to maximise consumer welfare will most likely differ from one that was designed to maximise the more general total surplus. An appraisal system planned to consider the welfare of consumers would not assign any weight to an increase in only producer welfare, whereas a system designed to consider total surplus would not consider the redistribution of income from consumers to producers as something that bears any weight.

4.3.1 Consumer Welfare Standard vs. Total Surplus Standard

According to the consumer welfare standard (CWS), a proposed merger should be allowed to proceed if the gains in productive or dynamic efficiency are substantial enough to ensure that no price increases will occur. The total surplus standard (TSS) approach calculates the consumer and the producer welfare, adds the two sums and does not consider any other aspects than maximising the total welfare result of the merger.¹⁴⁵ Even

¹⁴² De la Mano, Miguel (ed.) p. 10

¹⁴³ Neven, Damien; Nuttall, Robin; Seabright, Paul, p. 45

¹⁴⁴ de la Mano, Miguel (ed.), p. 18

¹⁴⁵ de la Mano, Miguel (ed.), p. 18

a merger resulting in higher prices may be cleared under a TSS if the efficiency gains realised by the merger surpass the losses suffered by consumers.¹⁴⁶ For this reason, efficiency gains resulting from a proposed merger would not have to be passed on to consumers, which should perhaps be considered as one of the basic incentives of Community merger control.

The consumer welfare concept includes not only the price aspects expected to result from a proposed merger, but also the quality of the respective products involved and whether the speed and security of supply will change due to the merger. Other aspects that are considered under a consumer welfare approach is product variety, level of innovation on the market and generally any variable that has the power to increase consumer welfare at the expense of producers.¹⁴⁷ When applying a merger control system based on a consumer welfare standard, wealth transfer from consumers to producers may not be considered in the merger assessment. Consequentially, the consumer welfare standard ordinarily requires a higher level of efficiency gains than the total surplus standard in order to outweigh the negative welfare effects of the merger. The most important, but certainly not the only, tool for assessing effects of a proposed merger under the CWS is the price level. The evaluation starts with accounting for the merger-specific cost savings and other efficiency gains and then proceeds to assess whether the profit-maximising price after the merger is higher or lower than the pre-merger price. Consequentially, implementing the CWS is analogous to an assessment of whether cost savings will be passed on to consumers.

When dealing with the impact of mergers on welfare, one must not forget that changes in the price level of a product will influence the consumers' demand for that product. A reduction in price will increase sales. To illustrate the effects of efficiencies on price decisions it is suitable to use a monopolistic market as an example. If a monopolistic undertaking reduces its price this will have three consequences: first, the monopolist achieves lower profits on its existing unit sales. Second, the undertaking will sell more units due to the lower product price and third, the undertaking's total cost will increase as a result of the additional production. At the level of output where the monopolist maximises profit, the result of these three effects is zero.¹⁴⁸ The explanation for this is that because undertakings will always strive towards maximising their profits, the monopolist will set marginal cost at the same level as marginal revenue. The net result of the three effects mentioned will however, change whenever efficiencies are involved in concentrations of undertakings. If the cost of the extra production resulting from the price increase becomes smaller as a result of efficiencies, the total net effect of the price decrease becomes positive.

¹⁴⁶ Luescher, Christoph, p. 78

¹⁴⁷ de la Mano, Miguel (ed.), p. 18

¹⁴⁸ Hausman, Jerry A.; Leonard, G.K., "Efficiencies from a consumer viewpoint", *George Mason Law Review*, 1999 7(3).

The conclusion to be drawn from this line of reasoning is that it is by no means certain that a merger will lead to price increases. Although the merged entity may still find it more profitable to raise its prices, it is not necessarily the most lucrative tactic. Instead, by including efficiency gains, a more profitable strategy could be to reduce prices and hence attract new consumers.¹⁴⁹ If the merger specific efficiency gains are large enough, this will result in the merged entity decreasing sales prices and consumer, as well as total surplus will increase. However, in order to decrease prices, the efficiencies expected to result from the proposed merger must be quite significant.

4.3.2 The welfare standard chosen for Community merger control

The Merger Regulation is undisputedly resting on the foundations of a consumer welfare standard. Article 2(1)(b) expressly declares that “technical and economic progress” may be considered in a merger appraisal, provided that it is to “consumers’ advantage”. Consequentially, the only thing relevant to the Commission is the consumer welfare, not the changes in producer welfare. But even if efficiencies can be identified and established to increase consumer welfare, they may only be taken into account so long as they do “not form an obstacle to competition.”

4.4 Efficiency assessment

In his paper on the competitive effects of efficiencies in European merger control, Miguel de la Mano identifies three factors as holding back the analysis of efficiencies in merger investigations. First, efficiencies and their competitive or welfare effects are very difficult to estimate in practise. Second, there is an uncertainty among legal academics as to what extent the Merger Regulation allows a weighing of the pro-competitive effects that merger-specific efficiency gains may have against the negative effects. Third, the fear that efficiencies may be used as an aggravating factor leading up to a prohibition decision has kept the merging parties from including efficiency gains in merger notifications.¹⁵⁰

4.4.1 The de la Mano seven-step analysis to appraise the impact of potential efficiency gains

Ordinarily, the Commission evaluates the competitive effects of mergers by analysing objective evidence regarding market concentration, barriers to entry, product characteristics and other factors observable on the market

¹⁴⁹ de la Mano, Miguel (ed.), p. 20

¹⁵⁰ de la Mano, Miguel (ed.), p. 1

being scrutinised. The anti-competitive effects should then be weighted against potential efficiency gains resulting from the merger. The quantification of efficiencies requires determining the capabilities of the undertakings operating on the relevant market in the absence of the proposed transaction, as well as evaluating how a concentration of the concerned undertakings would enhance those capabilities to a level that would not be possible otherwise. Ordinarily, that sort of assessment could not be performed without access to evidence that is under the sole control of the merging parties.¹⁵¹ The de la Mano seven-step analysis proposes to complement the current competitive assessment performed by the Commission in cases concerning the concentration of undertakings.

4.4.1.1 Isolate the motives for the merger

Generally, there are a number of justifications for an undertaking making the decision of entering into a concentration transaction. There are a number of economic theories concerning the question why companies wish to merge.

One of the theories is based on the efficiency increasing power of acquisitions through the exploitation of efficiencies, synergies or growth opportunities or by the removal of inefficient management. Another theory deals with the merging companies' willingness to diversify their respective business opportunities. Further, the market-power hypothesis focuses on the fight for market shares and the power to set price levels as the main objective behind merger decisions. A final theory considers concentrations as a reaction to a changed environment, such as new technologies or de-regulations, or to the policies adopted by the undertakings' competitors.¹⁵²

The reason for employing the method of establishing the underlying incentives of undertakings' decisions to merge is that the hypothesis that mergers which significantly increase the levels of concentration on a market are anti-competitive is only valid as long as no other credible explanation for the merger can be established. If the merging parties could be stimulated to carefully explain the rationale of their respective mergers, then the information submitted could perhaps help ascertain the credibility of the claimed efficiency gains.

4.4.1.2 Identify the nature of competitive interaction

There is a close relationship between efficiencies and market structure. For this reason, it is essential to evaluate which form of competitive interaction is present on the relevant market before the merger and also how it would develop after the merger, should it be allowed to continue.

Models of oligopolistic competition are frequently used to assess the effects of mergers. These types of models focus on the role of costs, the demand

¹⁵¹ de la Mano, Miguel (ed.), p. 40

¹⁵² de la Mano, Miguel (ed.), p. 41

situation at hand and the nature of competition. The majority of the models that presume non-collusion between the companies on the relevant market, make use of either the *Bertrand* or the *Cournot* competition model of oligopoly.¹⁵³ The Cournot model assumes that companies produce a homogenous product and that each respective company chooses the level of *output* that maximises its own profits, taking its competitors' output as a given. The Bertrand model, is often used to create a model of competition among sellers that produce differentiated products. This model assumes that companies set their *prices* non co-operatively in order to maximise profits.¹⁵⁴

4.4.1.3 Identify the nature of efficiency claims

Potentially, a large number of efficiency types may be considered in a merger assessment, such as economies of scale, plant specialisation, efficiency gains through improvements in distribution resulting from the merger, efficiencies gained through the combining of the merging parties' promotional assets and innovation efficiencies etc. Not all efficiencies are easily established nor are they equally likely to enhance competitive performance, and thus lead to lower price levels for the concerned consumers.

Cost-savings is not the only circumstance that matters. Improved quality, enhanced service and the levels of product innovation should also be taken into account. Cost savings that originate in a reduction in output, quality or variety should not be assigned any weight under a consumer welfare-based merger assessment system, as these kinds of cost-savings tend to cause impairment on the overall consumer welfare levels.¹⁵⁵

4.4.1.4 Verification

Generally, the access to relevant information regarding efficiencies is asymmetrical between the competition enforcement agency and the merging parties. The parties of the merger transaction are naturally more informed about the production structures and the functioning of the market. Consequentially, it is very possible that the information available to the competition enforcement agency is biased and exaggerated.

Ordinarily, merger appraisals are based on evidence originating from different sources, such as well-informed customers, suppliers, competitors, merging parties as well as other participants on the relevant market. The evidence provided may also be of various types, such as business documents, price lists and interviews with concerned customers.¹⁵⁶

¹⁵³ de la Mano, Miguel, p. 42

¹⁵⁴ Naturally, this is a gross simplification of the models' inherent differences, and the curious reader is directed to the original thesis by Miguel de la Mano ed.), with references, to establish a more thorough understanding of the relevance of the Cournot and Bertrand models.

¹⁵⁵ de la Mano, Miguel (ed.), p. 44

¹⁵⁶ de la Mano, Miguel (ed.), p. 48

There at least five possible fairly reliable sources of information:

- i) The most useful information will typically be found in management internal plans and cost studies drawn up in anticipation of the merger transaction. If the underlying incentive for the merger is the gaining of efficiencies, then the financial evaluations of the prospective cost savings will most likely be available and will probably offer a fair explanation of the efficiencies that the merging companies are pursuing.¹⁵⁷
- ii) Cross-sectional evidence describes the comparative achievements of variously sized firms in the industry world. Cross-sectional evidence may provide information such as evidence that larger firms within the industry are more profitable or have a greater growth speed than smaller firms which could be an indication that economies of scale are present.
- iii) Historical evidence may show that the merging undertakings have good prior qualifications when it comes to achieving efficiencies, which could come to enhance the credibility of their current efficiency claims.
- iv) Stock market data may provide information useful to assessments of the effects of a proposed merger. F. ex. the rise in the combined stock market value of the merging undertakings presents an upper limit to the value of the potential efficiencies expected to result from the merger.
- v) Evidence and studies put together in connection with the notification process of the merger may be assigned a certain amount of weight, but they ought to be regarded with some level of scepticism as they were not, in fact, included in the basis for the business decision.

The standard of proof imposed on the merging parties to present evidence that the proposed transaction is pro-competitive should be in parity with the standard of proof imposed on the Commission to establish the anti-competitiveness of the merger. In other words, evidence of the presence of efficiencies utilised to rebut the significant impediment on competition should not be held to a higher standard of proof than the details indicating plausible anti-competitive effects.¹⁵⁸

4.4.1.5 Merger specificity

It is not unusual that companies may achieve efficiency gains by engaging in internal expansion, joint ventures, specialisation agreements, lease-agreements, licensing or other contractual agreements.

However, in order for claimed efficiencies to be taken into account in a merger appraisal, they have to be merger-specific, i.e. they must be likely to

¹⁵⁷ de la Mano, Miguel (ed.), p. 48

¹⁵⁸ de la Mano, Miguel (ed.), p. 50

occur through the proposed merger and unlikely to be accomplished in the absence of either the proposed concentration, or some other means with comparable effects on competition.¹⁵⁹

It can be somewhat difficult to establish the likelihood of the transactions that may be pursued in absence of the merger under scrutiny: if an undertaking is inefficient due to lack of know-how in the company's management, the problem might be resolved by purchasing the know-how externally or by replacing the inefficient management. Nevertheless, the options may not be available or the transfer of know-how may not be expected to take place as cheaply or as completely as through a merger. Furthermore, it can not be assumed that the alternative cause of action will be less anti-competitive than the original plan to enter into a merger situation. The practicality and costs of the alternatives must always be considered, the merging undertakings should not have to justify excluding each possible alternative.

4.4.1.6 Quantification, likelihood and timing

The significance and weight assigned to the different types of efficiency gains should reflect their magnitude, likelihood and the time period expected to pass before the benefits to consumer welfare are realised. An at least rough quantification of the expected efficiency gains is essential to evaluate their significance. However, the need for quantification must not be over-emphasised as this may cause a risk of undue weighting issues.¹⁶⁰

Therefore, in practice, sufficient emphasis should be put on the likelihood that less-measurable efficiencies will take place.

Likely future competitive benefits often deserve less weight than likely current effects of similar magnitude.

4.4.1.7 Pass-on to consumers

In the context of a consumer welfare standard merger control system, it is essential that the Commission consider the extent to which the cost savings are passed on to consumers. If the post-merger market retains sufficient competition to benefit consumers by offering lower price levels after accounting for the likely merger-specific efficiencies then the conclusion should be that competition will not be significantly impeded as a result of the proposed merger transaction.

Five issues can be said to be important when assessing the levels of consumer pass-on:¹⁶¹

¹⁵⁹ de la Mano, Miguel (ed.), p. 50

¹⁶⁰ de la Mano, Miguel (ed.), p. 52

¹⁶¹ de la Mano, Miguel (ed.), p. 52-54

- i) The distinguishing between variable and fixed costs is essential, as in the short run only reductions in variable costs are directly passed on to consumers.
- ii) It is important to establish an appropriate time framework for considering pass-on, because in the long run, some categories of fixed costs may come to influence an undertaking's pricing decisions and should therefore be considered.
- iii) Generally, the stronger the rivalry is between competitors, the larger the rate of consumer passed-on cost savings will be. In other words, consumer pass-on levels are high where it matters the least, namely in highly competitive markets. However, efficiency gains will almost certainly be passed on to some extent, and even mergers resulting in monopoly may lead to price reductions and consumer welfare gains.¹⁶²
- iv) The calculation of consumer pass-on levels is often very difficult to construe, due to the rigidity of the models utilised to evaluate them, thus leaving little room for the irregularities present on any current market.
- v) Even though pass-on is ordinarily thought of as solely connected with price effects, it is essential to remember the necessity of evaluating efficiency claims that may be passed on to consumers in the shape of higher product or service quality, new products made available and greater innovation efforts.

4.5 External influence

It seems that the Merger Regulation is a competition instrument that has been steadily amended as a result of external influences. The European legislators have been glancing at other successfully regulated markets to select the respective successful solutions in order to create an effective and fully functioning merger control system for the Community.

The Merger Regulation applies to the territory of the European Economic Area (EEA). This trade area was created by the "EEA Agreement", which entered into force in January 1994.¹⁶³ The Commission has exclusive jurisdiction within the entire territory of the EEA to assess concentrations meeting the threshold requirements defined in article 1 of the Merger Regulation. Recital 11 states that "a concentration with a Community dimension exists... where the concentrations are affected by undertakings which do not have their principal fields of activities in the Community but which have substantial operations there". As a result of this the geographical scope of the Merger Regulation may be greater than can be expected at a first glance.

¹⁶² In a market where the competing undertaking collude, the degree of competition post-merger will depend on the ability of competitors to sustain the collusive behaviour after the merger.

¹⁶³ Verloop, Peter (ed.), p. 14

The increasing globalisation of markets has resulted in a significant increase in the number and scale of large cross-border mergers. An effect of this is that such concentrations of undertakings often have to be analysed by several competition authorities all over the world. The Commission is aware of this trend and has built a close relationship with foreign competition agencies regarding the treatment of such proposed mergers.¹⁶⁴ On an informal level, the International Competition Network (ICN) was introduced in October 2001. The ICN is meant to be a way for national competition authorities world-wide to interact on a consensus-based level thus facilitating the alignment of international rules concerning competition.¹⁶⁵

4.5.1 The North American influence

One of the most significant external influences on Community merger control is the method utilised by the North American competition authorities in their struggle against illicit concentration activities. The increased co-operation between EC and U.S. competition authorities has to some extent lead to a synchronisation of the parties' respective handling of concentrations of undertakings. I dare say, however, that the Community merger control has been more affected by the North American way of dealing with such cases than the other way around. There is definitely a growing need for international co-operation in the merger area of competition policy as an ever increasing number of concentrations have effects that stretch beyond the boundaries of one particular state, continent or trade area.¹⁶⁶ This need has to some extent been covered by the abovementioned reform of the Community merger control system, but the strive towards international convergence should be continuous, and even though the achievement of complete convergence is virtually impossible I believe that the attempts made are of great importance.

An example of a decision giving effect to the international scope of the Community merger control is the Commission decision regarding the *Boeing/McDonnell-Douglas* merger case. Although both undertakings were, and are still active mainly in the United States, their turnovers within the Community made the Regulation applicable to the concentration.

4.5.1.1 EC-U.S. Co-operation and co-ordination

As a result of the notably increased globalisation, the Community has had to construe agreements with the United States for co-operation and co-ordination of American as well as EU competition policies.

¹⁶⁴ Papaioannou, Anna; Diez, Ulrich; Ryan, Stephen and Sjöblom, Dan, "Green Paper on the review of the Merger Regulation", p. 66

¹⁶⁵ European Union Competition Policy, XXXI:st report on competition policy, p. 6

¹⁶⁶ Verloop, Peter (ed.), p. 15

An agreement was reached in 1991¹⁶⁷ and there are five principal duties placed on the parties¹⁶⁸ of the Agreement:

- a) to notify the other party where its enforcement activities may affect the activities of the other (Article 2)
- b) to exchange information (Article 3)
- c) to provide assistance (Article 4)
- d) to co-operate in the enforcement of the other's competition laws (positive comity) (Article 5) and,
- e) to have regard to the important interests of the other (traditional comity)(Article 6).

Confidentiality of information rules must be respected (Article 7).¹⁶⁹

The 1991 Agreement formalised the already existing practice between the competition authorities in the U.S. and the EC except for the positive comity obligation that is an important development of the actions towards co-operation and co-ordination.

The 1991 Agreement contains specific provisions regarding merger control, and the Agreement is defined to include merger control under the Merger Regulation. Shortly after its entry into force, France challenged the Agreement's legality. The Court of Justice held that although the Agreement was binding as a matter of international law (under the Vienna Convention) the Commission lacked the power to bind the Community as a matter of internal EC law.¹⁷⁰ The Council has now ratified the Commission's action by its decision of April 10, 1995.¹⁷¹

The Agreement in particular states that if a merger has been notified to one party's authorities and one or more of the involved undertakings are incorporated under the laws of the other party, these authorities must notify the other party's authorities if their enforcement activities may affect the other party's interests. The Agreement also contains provisions regarding the use of the information exchanged between the respective competition authorities as well as rules concerning the deferral or suspension of investigations or enforcement activities by one party during the time when enforcement activities of the other party are still going on.

The greater part of notifications made between the U.S. and EC authorities under the 1991 Agreement have been merger cases, such as the above-mentioned *Boeing/McDonnell-Douglas* case and *WorldCom/MCI*.¹⁷²

Apart from traditional comity, the co-operation has also involved consultations between case handlers regarding the relevant product and

¹⁶⁷ The 1991 EC/US Competition Co-operation Agreement [1991] O.J. L 131/38

¹⁶⁸ Duties are to be performed by the Commission regarding Community matters.

¹⁶⁹ Verloop, Peter (ed.), p. 14 f.

¹⁷⁰ Case C-327/91 *French Republic v. Commission* [1994] E.C.R. I-3641; [1994] 5 C.M.L.R. 517.

¹⁷¹ Council Decision [1995] O.J. L 143

¹⁷² Case [1991] *WorldCom/MCI* O.J. L116/1; [1999] 5 C.M.L.R. 876

geographic markets, the prospective anti-competitive effects of the concentrations, establishing law and fact in the other jurisdiction, and preventing contradictory commitments.¹⁷³ The prevention of contradictory commitments was of special concern in the *Boeing/McDonnell-Douglas* case.

The U.S. authorities have participated, as observers, in the Commission's hearings in several cases. However, confidentiality rules must of course be respected unless the parties give up these rights.¹⁷⁴ The intertwining of the respective competition authorities' investigations and hearings is something that has, and probably will to a greater extent in the future, affect the methods used as a tool for defeating non-competitive mergers.

The Agreement was reinforced in 1998 by the conclusion of a further Agreement on the operation of the positive comity principle.¹⁷⁵ This particular agreement does not, however, apply to concentrations of undertakings, as a result of the mandatory and tightly time-limited obligations of the Commission under the Merger Regulation.¹⁷⁶

4.5.1.2 The SLC-test (Significant Lessening of Competition)

Section 7 of the U.S. 1914 Clayton Act prohibits any concentration the result of which “*may be substantially to lessen competition, or to tend to create a monopoly*”.¹⁷⁷ Early U.S. merger decisions contained an efficiency offence rather than an efficiency defence. In the *Brown Shoe* case, the court stated potential efficiency gains resulting from the merger as a reason for disallowing it.¹⁷⁸ The interpretation of the SLC-test has however changed over the years, and the current U.S. approach to efficiencies in merger cases was first formulated in 1984. In the 1982 Merger Guidelines efficiencies were still classified as a defence. Revisions brought forward in the 1984 Merger Guidelines expressly stated that efficiencies “do not constitute a defence to an otherwise anti-competitive merger” but rather were “*one of the many factors [...] considered by the Department in determining whether to challenge a merger*”.¹⁷⁹ Hence, the 1984 revision resulted in the efficiency claims being moved from the “defences” section to the “other factors” section.

Most jurisdictions that rely on the SLC test also have an efficiency test.¹⁸⁰ However, efficiency claims are not recognised as an affirmative defence in

¹⁷³ Cook, C.J.; Kerse, C.S., p. 15

¹⁷⁴ Cook, C.J.; Kerse, C.S., p. 15

¹⁷⁵ Decision of the Council and of the Commission of 29 May 1998 concerning the conclusion of the Agreement between the European Communities and the Government of the United States of America on the application of positive comity principles in the enforcement of their competition laws [1998] O.J. L 173.

¹⁷⁶ Cook, C.J.; Kerse, C.S., p. 15

¹⁷⁷ de la Mano, Miguel (ed.), p. 77

¹⁷⁸ *Brown Shoe Company v. United States*, 370 US 294 [1962].

¹⁷⁹ de la Mano, Miguel (ed.), p. 77

¹⁸⁰ Voigt, Stefan; Schmidt, André, p. 589

the U.S., but can rather be described as a factor that may be weighted in the assessment of the net competitive effects of a proposed merger.¹⁸¹ This means that, in practice, the U.S. Merger Guidelines allow the application of an efficiency rebuttal rather than an efficiencies defence. This means that efficiencies may be seen as a factor with the power to possibly outweigh some level of anti-competitiveness in proposed merger, rather than a factor able to change the actual outcome of the merger case.

According to the 1992 Guidelines, the U.S. Department of Justice considers potential merger-specific internal efficiency gains, such as cost savings, in their assessments of proposed concentrations of undertakings.¹⁸² The 1992 Guidelines also emphasise efficiencies that result in technical rationalisation, such as efficiencies associated with economies of scale, higher levels of production facilities integration, plant specialisation and lower transport costs.¹⁸³

In 1997, efficiencies were again the subject of a revision. The revision formalised the use by the U.S. enforcement agencies of a consumer welfare standard (CWS). It also explained the significance of establishing the different types of efficiencies, merger specificity, verifiability, pass-on to consumers and the net effects.¹⁸⁴

As recommended in the 1997 Merger Guidelines, the U.S. agencies should evaluate the likely magnitude, scope and duration of any price-increase that may be anticipated to arise as a result of a proposed merger in their assessment of whether competition is likely to be prevented or substantially lessened. It appears that the U.S. agencies have been more willing to accept and take account of efficiencies that are predicted to realise over significant periods of time.¹⁸⁵ In other words, efficiencies may be taken into account despite a certain time lag between the realisation of a proposed merger's effects on competition and the achievement of efficiencies. The important thing is that the efficiencies are passed on to consumers, perhaps in the form of decreases in price levels. The competition authorities should also consider whether the respective efficiencies might be considered as sufficient to make up for the potential harm to consumers in the relevant market-/s, perhaps by holding back or preventing price increases in that market. It is stated in the revised Merger Guidelines that "*expected net efficiencies must be greater the more significant are the competitive risks*" involved in the proposed transaction.¹⁸⁶ This is called the "sliding scale approach"¹⁸⁷, and the meaning of it is that larger market concentration levels, higher market shares or barriers to entry as well as lower market demand elasticity, require equally large efficiency gains in order to

¹⁸¹ de la Mano, Miguel (ed.), p. 77

¹⁸² Neven, Damien; Nuttall, Robin; Seabright, Paul, p. 62

¹⁸³ Neven, Damien; Nuttall, Robin; Seabright, Paul, p. 62

¹⁸⁴ de la Mano, Miguel (ed.), p. 77

¹⁸⁵ The long-term focus is of the essence.

¹⁸⁶ Neven, Damien; Nuttall, Robin; Seabright, Paul, p. 62

¹⁸⁷ de la Mano, Miguel (ed.), p. 78

counterbalance the potential anti-competitive effects of mergers in the respective markets. Even merger-specific efficiencies that may be difficult to predict might influence a merger decision in a positive direction, due to the abstract character of assessments of potential anti-competitiveness in merger cases. As described, efficiencies may play an important role in the U.S. merger assessments. This may however be hard to detect and examine, as the U.S. competition authorities do not need to disclose the underlying reasons for allowing a merger to proceed.

5 The future of EU merger control

5.1 Flexibility vs Predictability

The basic theme of all merger control is determining whether a proposed merger will fall into one of two categories: it will either be deemed as compatible with the relevant concept of competition or it will not, and the manner in which proposed mergers are scrutinized is the essential constituent of merger policy.¹⁸⁸ The structure of the test utilized will influence the number and characteristics of the mergers that are notified because the undertakings that are entertaining the idea of entering into a merger agreement will have certain expectations regarding whether or not their proposed merger will be allowed to proceed. These expectations will be based on the characteristics of the relevant substantive test, and the weight that is assigned to surrounding factors, such as efficiencies.

As described above, the substantive test used in Community merger control has been changed recently, and any such legal changes are likely to enhance the level of uncertainty because those who are subject to the legislation can not be sure of how the Commission and the courts will interpret the introduced novelties. These uncertainties are likely to translate into higher costs; at least until a new equilibrium level with a higher degree of predictability has established itself.¹⁸⁹ I believe that it is safe to say that this equilibrium level has yet to be reached, as the role played by post-merger effects and the extent to which more dynamic influences, such as efficiencies, may be taken into account in the Commission's merger assessments has still not been adequately determined.

The new SIEC test indicates that the number of notified mergers that can be prohibited is larger than it would have been under the dominance test, as the constraint of having to prove the creation or strengthening of a dominant position has been removed. Other aspects contributing to this increased scope of applicability potentially leading to a stricter merger policy are:

- Non-coordinated effects may now be taken into account, regardless of whether they create or strengthen dominance;
- These non-coordinated effects will be relevant to all sorts of oligopolies, not merely to highly concentrated oligopolies;
- In the Horizontal Mergers Guidelines, paragraphs 61 through 63 are under the heading "Mergers creating or strengthening buyer power

¹⁸⁸ Voigt, Stefan; Schmidt, André, p. 584

¹⁸⁹ Ibid. p. 585

in upstream markets". This wording may indicate that vertical or conglomerate issues are taken into account.¹⁹⁰

The mere possibility that the abovementioned aspects of the reformed Community merger control system may lead to a more restrictive policy, could be a source of undesired and inefficient unpredictability.

This leaves the Commission with a wider competence regarding the number of proposed mergers that can fall under the scope of the Merger Regulation. This too adds a dash of uncertainty for the market actors of the Community. If the market actors are not certain of how to interpret the relevant competition rules, this may lead to a number of negative welfare effects: if market actors believe that a merger will not be allowed to proceed, mergers whose consummation would realise efficiency gains would perhaps not take place, resulting in a lower level of productive efficiency. Here the Commission has an awesome responsibility when managing the extended possibility to intervene in merger activities.

Precedent signalling too strict of an attitude towards proposed mergers can be a hindrance to the realisation of welfare gains: mergers with the potential to enhance welfare might be discouraged by precedent, thus preventing the realisation of important productive efficiencies.¹⁹¹ Predictability is an important factor that lets market actors make more accurate forecasts regarding the decisions of the relevant competition authorities. But it is not merely precedent cases that determine the level of predictability: it is also of considerable importance that the merger assessment criteria utilized by the relevant competition authority are as straightforward and clear as possible.

If the merger policy of the Community was perfectly predictable, there would be no prohibitions because prohibitions are very expensive. But predictability should ultimately increase over time due to the reduction of uncertainty concerning the interpretation of legislation by the relevant competition authority. As the number of cases dealt with by the Commission increases, the possibility for market actors to assess the potential outcome of their proposed merger agreements will also improve. And in the future, the levels of predictability and transparency should reach a new and more efficient equilibrium level.

One of the reasons for altering the substantive test in Community merger control was that it brought about an increased level of flexibility. Although the strive towards increased levels of flexibility is generally considered to be a positive endeavour, there are certain downsides to this development. When achieving high levels of flexibility, one also attains a lower degree of predictability.

¹⁹⁰ Voigt, Stefan; Schmidt, André, p. 589

¹⁹¹ Ibid. p. 586

As a result of the merger control reform described earlier in this thesis, efficiencies were given a more explicit role. This increase in the possibility for merging firms to claim an efficiency defence may prove to be a counterweight to the risk that merger policy becomes too restrictive in the future.

It appears that the introduction of the new substantive test potentially enables the Commission to take a more restrictive approach in their merger assessments, whereas the launching of a more explicit position of efficiencies enables it to be less restrictive, thus contributing to a more balanced merger control situation.¹⁹²

5.2 From static to dynamic

It is obvious from the Merger Regulation that the objective of Community merger control is to preserve and promote an effective competitive structure within the common market to the benefit of consumers. To assess whether a merger is likely to result in anti-competitive effects, such as price increases to the detriment of consumers, it has previously been the Commission's practise to focus on mergers that would tend to create or strengthen an undesirably concentrated market structure. This structural approach is static and refers to the immediate effects of a proposed merger, such as price changes that are likely to result from the merger.¹⁹³ When applying a structural approach to merger assessments, there is little or no possibility for efficiencies to be included as the structural criteria sets an upper limit and efficiencies may not be taken into account above this level. But if the analysis is based on actual welfare effects, possible efficiency gains have to be a part of the analysis as they for the most part have the effect of increasing the levels of welfare.¹⁹⁴ Many merger control systems have come to the conclusion that it may be advisable to conduct a more dynamic analysis of the effects of proposed concentrations. Dynamic analysis is an analysis of the change in prices and characteristics of the merging parties and the merged entity that are likely to occur as a result of the merger.¹⁹⁵ A dynamic merger assessment model takes into account the fact that the merger will change the incentives that determine entry, investment and exit decisions on the relevant market/-s if it is allowed to proceed.

Concentrations that, through creating or enhancing a dominant position within the common market or a substantial part of it, have a significant adverse impact on competition and risk being prohibited. The criteria to be considered in determining compatibility with the common market have been purely competition based: the need to maintain and develop effective

¹⁹² Ibid. p. 589

¹⁹³ Hildebrand, Doris, p. 167

¹⁹⁴ Strohm, Andreas, "Efficiencies in Merger Control: All you Always wanted to Know and Were Afraid to Ask", European Commission, 2005

¹⁹⁵ de la Mano, Miguel (ed.), p. 7

competition and the market position of the undertakings concerned.¹⁹⁶ It is clear that the Merger Regulation has been applied with such a focus on competition-related factors that the scales are weighted against letting other factors be taken into account, let alone be given the power to influence a final judgement of compatibility.¹⁹⁷ It has to be acknowledged that a number of key factors in an assessment decision are difficult to measure and predict accurately, and that a final compatibility-judgement contains not necessarily one but often several finely balanced judgements leading up to the final conclusion. These may be contributing factors to why the Commission has chosen such a cautious approach in allowing concentrating undertakings to defend their proposed merger transaction by presenting justifications that are not necessarily considered as purely competition-based.

With the introduction of the new substantive test focus has been shifted to examine changes to the competitive environment resulting from the proposed merger, and not on whether the merged object achieves an unacceptable degree of market power. In other words the SIEC test analyses the degree of change in the dynamics of competition caused by the proposed merger, whereas the dominance test focuses on how much competition is left over and not how much has been lost.¹⁹⁸ Under the old substantive test mergers could be challenged based merely on structural indicators.

By removing dominance as a necessary prerequisite, it can be said that the new SIEC test points more specifically towards one of the main economic questions caused by mergers: can it be expected that allowing the proposed merger will result in competition being reduced? This line of reasoning is effects-based and will hopefully lead to less merger prohibition decisions in cases where the proposed merger would have been pro-competitive. The more positive attitude toward efficiencies that has been acknowledged lately goes hand in hand with this move towards an effects-based merger assessment, as the concept of efficiencies is such a dynamic factor that is supposed to be included in the evaluation of the post-merger competition environment. In order to facilitate a focus on competitive effects, it is imperative to increase the level of knowledge concerning industrial economics. The market analysis should be guided towards an investigation of the economic motivation of the proposed merger as well as an assessment of the expected conduct by market actors after the merger.

As of yet no cases have been introduced in which efficiency gains have been explicitly mentioned as an integral part of a decision to allow a proposed merger to proceed. Most cases dealt with by the Commission are still based on dominance. But there have been some recent cases where dominance has played a diminutive role, such as *Johnson&Johnson/Guidant*¹⁹⁹,

¹⁹⁶ Lane, Robert, p. 264

¹⁹⁷ Cook, C.J.; Kerse, C.S., p. 175

¹⁹⁸ Rölller, Lars-Hendrik; de la Mano, Miguel, 2006, p. 12

¹⁹⁹ Commission case M.3687 *Johnson & Johnson/Guidant*

*Siemens/VA Tech*²⁰⁰, *Lufthansa/Swiss*²⁰¹ and one case where dominance was never even mentioned: the *Total/Gaz de France*²⁰² case. The change towards a more effects-based system is obviously slow and gradual. Case-handlers have to become accustomed with the new Merger Regulation and the Horizontal Mergers Guidelines, and there is perhaps still little incentive for merging parties to present efficiency claims. If efficiencies can not trump a finding of dominance, the market actors may find it best to focus on rebutting such a finding of dominance instead of spending time, effort and indeed capital on introducing an efficiency defence.²⁰³ It may be considered that it is better to “disprove” dominance than to prove efficiencies. This development is of course neither economically efficient nor desirable from an effective merger control perspective, and should be given due attention in the future.

²⁰⁰ Commission case M.3653 *Siemens /VA Tech*

²⁰¹ Commission case M. 3770 *Lufthansa/Swiss*

²⁰² Commission case M. 3410 *Total/Gaz de France*

²⁰³ Röller, Lars-Hendrik; de la Mano, Miguel, 2006, p. 18

6 Concluding remarks

The basic theme of this thesis has been the presence of efficiencies in Community merger control.

The explicit reference to efficiencies in the Horizontal Mergers Guidelines seems to be enough for the Commission to believe that a change in attitude has taken place. This is something that should not be taken for granted, in combination with the caution following the affirmation of the concept of efficiencies, it must be questioned whether the result of merger appraisals will in fact be any different than before the reform package was adopted.

However, one of the incentives behind the overhaul of the Community merger control system was to ensure that the Commission's merger appraisals are conducted in a way that is more thorough, more focused, and more firmly grounded in sound economic reasoning. As a result, the economic soundness of the Commission's decisions in merger cases should be enhanced. This may indicate a more obvious and more conspicuous presence of efficiencies in Commission investigations of the potential competitive effects of a proposed concentration on the relevant market under scrutiny. The increased presence of efficiencies will most likely legitimise an ever evolving tendency to assign more weight to strictly econometric evidence regarding the advantages, or indeed disadvantages, of the merging of companies' respective businesses. Consequentially, the influence of econometric models designed to evaluate efficiency gains resulting from mergers is also likely to increase.

To conclude this thesis, an introduction will be offered of a bold and perhaps unrealistic, yet interesting solution to the problems currently occurring in the area of merger control, regarding the non-convergence of merger control systems world-wide.

The *G.E./Honeywell* case caused a debate on the creation of a uniform world-wide competition law to re-surface, after having been dormant for a period of time.²⁰⁴ The ever-increasing number of national competition authorities has led to a level of confusion and disparity concerning which merger control system will ultimately be applied to the possible concentration of companies. The divergence of the results of concerned competition authorities are likely to cause large levels of sunk costs for parties' involved in merging transactions, if the merger is allowed within one jurisdiction but ultimately prohibited in another. F. ex. Honeywell stated in a June 2001 press release, that their estimated loss incurred by its company alone originating from the Commission decision to prohibit the

²⁰⁴ von Meibom, Wolfgang; Dr Geiger, Andreas, "A World Competition Law as an Ultima Ratio", *European Competition Law Review*, [2002] Issue 9, p. 445

merger, was closer to US\$ 42 million.²⁰⁵ Apart from this highly inefficient allocation of capital, problems are likely to occur regarding the lack of legal certainty that non-converging merger control systems will inevitably cause.

The increased levels of globalisation and internationalisation in notified mergers world-wide has brought forward thoughts on a single uniform competition law, to be applied on a global scale. However, the infinite and perhaps unforeseeable effects of such a bold move would be extraordinarily difficult to assess, hence making it a very difficult transaction to realise.²⁰⁶

Could this possibly be the future of trans-national merger control, or is it merely a theoretical ivory-tower, completely incapable of dealing with the infinite levels of complexity inherent in such concentration transactions?

²⁰⁵ von Meibom, Wolfgang; Dr Geiger, Andreas, p. 446

²⁰⁶ This is the author's own opinion, and an interested reader is advised to consult the article by von Meibom and Dr Geiger where a range of correctives designed to outweigh these difficulties are presented.

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