



FACULTY OF LAW
University of Lund

DANIEL KANTER

COLLECTIVE DOMINANCE – NO
LONGER A CONCEPT IN EC
MERGER CONTROL?

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Hans-Henrik Lidgard
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SUMMARY

The Commission thought of an ingenious method to prohibit mergers based on collectively held dominant positions.

However the CFI, in Airtours, quashed the Commission's findings and laid down the following provisions.

Transparency, retaliatory measures and competitive fringe, a tripartite test, must now be present.

For a finding of collective dominance, we need no other element.

But the highest of obstacles in relation to collective dominance stand in remain..

For the Court have raised the standard of proof, convincing evidence must now be sustained.

The Commission issued the merger guidelines, believing these would the situation heal.

Accepting the test in Airtours is a step on the way, but guidance on evidence remain concealed.

Collective dominance – no longer a concept, this thesis suggests.

There will be no prohibition of mergers, until the assessment of evidence can comfortably rest.

We therefore await the ECJ's judgment in the decisive Tetra Laval appeal.

Aspirations are high that the case of collective dominance will then be sealed!

Brussels, January 15 2004

ABBREVIATIONS

CFI	Court of First Instance of the European Communities
CMLR	Common Market Law Report
EC	European Community
ECJ	Court of Justice of the European Community
ECLR	European Competition Law Review
EEA	European Economic Area
EEC	European Economy Community
EU	European Union
DG	Directorate General
OJ	Official Journal of the European Community

1 INTRODUCTION

1.1 Abstract

One of the fundamental issues for the functioning of the European Community has been to develop an efficient instrument in order to control that competition is ensured within the common market¹. During the last couple of years there has been a tendency within the European Commission to prioritize the fight against international cartels, abuses of dominant positions and measures to break up state monopolies. These areas are covered by articles 81 and 82 of the Treaty of Rome (EC Treaty).

An increasingly important area is Merger Control. The European Community Merger Regulation² (Merger Regulation) entered into force on 21 September, 1990 and underwent significant changes in 1998. The idea behind the Merger Regulation was that the creation of an internal market would give companies within the European Union the incentive to engage in cross-border transactions at a larger scale than before. It was thus considered important to create an instrument preventing such transactions from lasting deterioration of competition.

1.1.1 Oligopolistic Markets

Modernization, globalization and the internal market, have led to a growing number of oligopolies in the European Union. Such development can easily have a negative impact on competition. For this reason, the Commission has engaged in a new Merger Control policy, collective dominance.

In an oligopoly, individual firms' decisions on output affect market prices and firms are no longer price takers. For the firms to engage in the optimal choice, they must look at its competitors' expected reactions. In general, members of an oligopoly try to establish qualified assumptions in what those reactions would be.³

To analyze oligopolies in light of competition is particularly difficult. For this reason, there is not an explicit model dealing with the competition concerns of oligopolies; different national regimes use different models. There is also relatively little guidance in terms of legislation from various international competition authorities⁴, resulting in an ambiguous situation

¹ Treaty of Rome article 3.1.g

² Regulation 4064/89, [1989] OJ L 395/1, as amended by Regulation 1310/97, OJ [1997] L 180/1.

³ *Merger Control in the EU*, Edurne Navarro, Andrès Font, Jaime Folguera and Juan Briones. 2002, p. 197.

⁴ The US Federal Trade Commission published guidelines in 1992. These are similar to the Canadian Merger Enforcement Guidelines. The German *Bundeskartellamt* deals with oligopolies in its 1990 procedural guidelines for the control of concentrations. The UK Merger and Monopolies Commission has published a brochure which deals somewhat with the assessment of oligopolies, although not explicitly.

for firms, which form part of oligopolistic markets since there are no clear and simple rules.

Competition authorities should only have concerns when a small group of suppliers jointly have a large share of output in markets with certain characteristics⁵. However, it is important to remember that concentrations in oligopolistic markets can have either positive, negative or neutral effects on competition.

1.1.2 *Collective Dominance*

Collective dominance is understood as a dominant position held by several independent undertakings in a market. In EC merger control, the notion of “collective” or “joint” dominance, is treated as the equivalent of oligopolistic dominance⁶ and can consist of no more than three to four undertakings⁷. Collective dominance can arise if there are only a few competitors in a specific market making their strategic decisions on basis of the prospective conduct of their rivals⁸. In these circumstances, there is a non-cooperative strategic interaction between the members of the oligopoly without an explicit anti-competitive agreement within the meaning of article 81(1) of the EC Treaty. If a merger enables the parties forming the oligopoly to increase their profits by actions, which depend for their success on cooperative responses from other suppliers (i.e. tacitly coordinated activities), they may be able to increase prices or reduce quality standards. In economic theory (see section 2 below), this is commonly referred to as oligopolistic interdependence. The result is strikingly close to that of a monopoly or a cartel situation⁹. It is however possible that the oligopoly remains competitive; as members of an oligopoly may react differently, it is possible that there will be a market equilibrium, in which none of the oligopolists is able to achieve its maximum profits, e.g. competition is maintained.

The Merger Regulation does not explicitly deal with oligopolistic markets and the assessment of collective dominance. The control of concentrations is based on the concept of dominance and its regulating article is 2(3) of the Merger Regulation¹⁰. The article stipulates a two-step test: “...*a concentration which creates or strengthens a dominant position*” with the prospective result that “...*effective competition would be significantly impeded*”.

Instead, the Commission developed the concept of collective dominance through its case law by referring to the Merger Regulation article 2 (3). This

⁵ These *characteristic markets* in EC-assessment of oligopolistic markets will be thoroughly explained for at a later stage in the thesis.

⁶ Case COMP/M.2498 *UPM-Kymmene/Haindl*, para 75.

⁷ M.1016 *Price Waterhouse/Coopers Lybrand* [1999] OJ L50/27 para 51.

⁸ *Collective Dominance under Article 82 EC and EC Merger Control in the light of the Airtours Judgment*, p 435, European Competition Law Review, volume 23, Issue 9, September 2002.

⁹ US Horizontal Merger Guidelines, 1992 (amended 1997), para.2.1.

¹⁰ As of 1 May 2004, the dominance test will have a different reading. See section 6 below.

was not recognized by the European Court of Justice (ECJ) until 1998 in *France and others v. the Commission*¹¹. The assessment made by the ECJ was later confirmed by the Court of First Instance (CFI) in *Gencor v. the Commission*¹².

It has predominantly been the Commission that has set up the framework for the assessment of collective dominance. However, the CFI has in a number of recent cases criticized the Commission's working methods. The CFI's decision in *Airtours v. Commission*¹³ entailed, in very hard wording, a complete quashing of the Commission's decision in *Airtours / First Choice*¹⁴, which prohibited the merger on basis of collective dominance. The CFI highlighted two points as particularly important:

1. A merger cannot be blocked simple because it reduces the number of firms in oligopolistic markets. Nor can a merger be blocked because firms determine their strategies on the basis of their competitors' strategies;
2. The Commission carries a high burden of proof. The Commission must present convincing evidence before prohibiting a merger transaction¹⁵.

The decision was the first in a number of recent judgments, where the CFI overturned a prohibition decision taken under the Merger Regulation and call into question the future assessment of EC Merger Control. Although the Merger Regulation, through established case law, deals with collective dominance, the *Airtours* decision, with the very high standard of proof, which the Commission must present, cast strong doubts as to whether it will ever be possible to sustain a finding of collective dominance in oligopolistic markets in the future.

1.2 Purpose

This thesis aims to show how the Merger Regulation is applied in situations of collective dominant positions. The thesis will examine the "birth" of collective dominance and scrutinize how subsequent case law has formed the concept to what it was yesterday, what it is today and what it perhaps will be tomorrow.

The primary purpose of this thesis is to examine whether collective dominance, as a concept, still exists in EC Merger Control in light of the CFI's judgment in *Airtours v Commission*.

¹¹ Joined cases C-68/94 and 30/95 *France and others v. Commission* (31 March, 1998).

¹² T-102/96 *Gencor v. the Commission* (25 March, 1999).

¹³ T-342/99 *Airtours v. Commission* [2002]

¹⁴ Case IV/M.1524 *Airtours/First Choice* [2000] OJ L93/1

¹⁵ See para 294 in the CFI's judgment in *Airtours v. the Commission*: "...vitiating by a series of errors of assessment as to factors fundamental to any assessment of whether a collective dominant position might be created".

1.3 Method

This thesis is primarily based on a traditional legal method. Inherent here is the systematization and the structuring of relevant material, which is necessary in order to present the legal treatment of the topic.

The natural emphasis for the named method is the analysis of EC case law, which provides a useful point of reference in explaining the past, present and future assessment of collective dominance. This thesis analyzes both early cases such, as *Nestlé/Perrier*¹⁶, and more recent cases, such as *Airtours*. The idea is to give an overview of how the Commission (and where applicable the ECJ and the CFI) has assessed collective dominance in the past and how rapidly the assessment has changed.

The reasoning behind the legislation and case law in EC Merger Control derives from various economic theories. These will be explained, in brief, in section 2. It is important to know these economic theories since they are the fundamentals in the assessment of collective dominance made by the Commission, the CFI and the ECJ. Different economic theories are discussed in order to provide the reader with the relevant ground tools.

Apart from case law, I have used information from legal, political and economical experts in textbooks and articles. Moreover, I have used and analyzed Community Legislation, in particular the Merger Regulation, and the draft Commission Notice on Horizontal Mergers (the merger guidelines).

¹⁶ M. 190 *Nestlé/Perrier* [1992] OJ C 53.

2 ECONOMIC THEORY

2.1 Introduction

The criteria laid down in article 2 of Merger Regulation are vague concepts to assess risks of collective dominant positions. Since the article itself does not provide with sufficient guidance, one must engage in a deeper economic analysis in order to bring about the factors, which will either establish or deny the risk for collective dominance. The following intends to bring about the central economic theories in oligopolistic markets necessary to understand the reasoning behind the concept of collective dominance as laid down by the Commission, the CFI and the ECJ. In order to be able to relate to the concept of collective dominance, it is necessary to first give an overview of the general economic theories used in competition law.

2.1.1 *Perfect Competition, Monopoly and Oligopoly*

An industry, in which there are so many firms that none of them can influence the market price by its individual decisions and, in which there are so many consumers that the individual utility-maximizing decisions remains the same, leaving the market price stable, is called a *perfect competitive industry*¹⁷. The buyers and the sellers substitute perfectly for each other; no one has the power over the contractual terms since any buyer or seller who is dissatisfied can get an alternative contract with someone else, e.g. no firm has any market power, since the price is determined by market forces.

As the availability of substitutes decreases, *perfect competition* approaches its polar side, namely *monopoly*. A monopolist is defined as the only firm of a product, for which no substitutes exist¹⁸. A monopolist will dictate the price and conditions of a contract alone; the buyer can either choose to accept the terms under the contract, or stand without a contract and the subsequent good. It is generally understood that monopolies, in any form, are inefficient. The reason for this is that monopolists (as a general rule) set prices too high, with the direct result of distorting the economy. In economic theory, a price is set too high when it exceeds the marginal cost of producing the good. When price exceeds the marginal cost, some consumers, will choose not to purchase the good. If producing the good costs less than people would be willing to pay for it, then not supplying the good is inefficient. Hence, monopoly is considered inefficient.¹⁹

In addition to *perfect competition* and *monopoly* one can distinguish market structures intermediate to the two extremes. The two most important amongst these are *oligopoly* and *imperfect competition*. For the purpose of this thesis, focus is on the former. An oligopolistic market consists of a few firms that recognize that, in order to maximize their individual profits, they

¹⁷ See Robert Cooter and Thomas Ulen, *Law & Economics*, third edition, 1999, p. 29.

¹⁸ *Ibid.* p. 277.

¹⁹ *Ibid.* p. 277.

must rely on interdependent decisions with the other firms. To clarify, the optimal market behavior for company A depends not only on its marginal cost and demand for its output, but also on the output on firms B, C and D and the prices they have decided to charge.

2.2 Harvard School

The Harvard school is founded on empirical facts. Its emphasis lies on the relevant markets and its central concept deals with barriers to entry and analyzing market power. The Harvard School developed the concept of *Structure, Conduct, Performance Paradigm* (the S-C-P paradigm), which tries to achieve a general theory identifying common elements in the market structure of any industry into a performance indicator of that sector. The theory was developed in the late 1930's and early 1940's by Edward S. Mason²⁰. The S-C-P paradigm examines the factors causal to firms' behavior²¹. The paradigm implies that market results in an industry (e.g. the success of a firm in producing benefits for consumers, employment, stable prices, technological advancement, etc.) depends on the conduct of the buyer and the seller (typical examples are advertisement and R&D). Conduct is determined by the structure of the relevant market. The structure of an industry depends on basic conditions such as technology and preference structure. The conduct of governmental bodies (antitrust policy, regulation and taxes) may affect the basic conditions and thus the structure, conduct and performance in an industry²². The S-C-P paradigm condemns high degrees of concentration. Regarding market shares, the paradigm aims at showing a direct relationship with market power.

There have been numerous studies relating to the S-C-P paradigm, of which many have found a positive and significant relationship between market structure and performance, yet others have been critical as to whether the relationship would hold for different sets of industries or in different times. Further, with regards to barriers of entry, studies have shown that the notion of entry barriers is unclear and have been given too much weight in the analysis of market structure²³. Another weakness in the theory concerns the conduct element in the S-C-P paradigm approach. Since diversity and obscurity of conduct makes it difficult to accurately measure patterns of market conduct, no meaningful association can be established between market structure and market conduct²⁴. The core of the Harvard School's S-C-P paradigm is an increasing state intervention in competition – competition must be strongly regulated by the authority.

Although the Harvard School may not be completely accurate, it nonetheless put forth some fascinating and highly valid ideas. Interestingly,

²⁰ Patrick van Cayseele, Roger van den Bergh, *Encyclopedia of Law - Antitrust Law*, 1999, p. 472.

²¹ Doris Hildebrand, *The Role of Economic Analysis in the EC Competition Rules*, 1998, p. 156.

²² See Cayseele & Bergh, p. 473.

²³ John Burton, *Frontiers of Competition Law*, 1994, p. 10.

²⁴ See Hildebrand p. 161.

the founder of the S-C-P paradigm has stated that “*monopolistic elements are practically everywhere and always there*”²⁵. This is an important statement and coincides with the notion given above regarding oligopolistic markets. Depending on the extent to which activities are being (tacitly) coordinated, oligopolistic markets can have strong monopolistic elements.

2.3 Chicago School

The Chicago School can be seen as the answer to the Harvard School’s deficiencies. It was founded and developed by Stigler and Director (two professors at the University of Chicago) in the early 1950’s. In sharp contrast to the Harvard School’s S-C-P paradigm, which examined competition problems based on empirical research, the Chicago School represents the view that concentration will always be the result of *efficiency* and thus rejected the idea of governmental intervention in competition policy²⁶. Director reached his conclusions by analyzing competition problems through price theory; he sought an explanation for practices observed in real markets, which included maximization of profits, utility and welfare²⁷. Stigler showed that it was often more profitable to stay out of cartels than to form them. (Evidently, this conclusion has been both rejected²⁸ and confirmed.)

In sharp contrast to the Harvard School’s S-C-P paradigm, the Chicago tradition has a ‘laissez-faire’ approach to competition and monopoly situations. It considers competition as a dynamic process empowered by the self-regulation of the market leading to ultimate efficiency.

Stigler brought forth one of the most important attacks on the S-C-P doctrine; the Harvard scholars often argued that fixed costs would lead to scale economies on the one hand and barriers to entry on the other. Stigler defined a barrier to entry as ‘*a cost [...] that must be borne by a firm which seeks to enter the industry but is not borne by firms already in the industry*’²⁹. The significance of the citation is that barriers to entry are only present if the costs for firms entering a market turn out to be higher than the costs for the existing firms³⁰. If the costs for entering a market turn out to be lower or the same, there are no cost disadvantages for new entrants for initial ideas regarding the importance of sunk costs rather than fixed costs.

In short, the Chicago school consists of several ingredients, which taken together concludes that the monopoly and the oligopoly problem is not all

²⁵ See Hildebrand p. 159.

²⁶ See Cayseele & Bergh p. 475.

²⁷ *Ibid.*

²⁸ The critics have said that one must first carefully investigate the nature of the transactions that takes place in an industry (See R Deneckere and C Davidson, *Horizontal Mergers and Collusive Behavior*, 1984, p. 117-132).

²⁹ See Cayseele & Bergh p. 476.

³⁰ This can be envisaged by the following example: it costs 10 million dollars to build the smallest possible efficient factory having an economic life of ten years. The annual costs for new entrants would be 1 million dollars annually. The existing firms will be confronted with the same annual costs since they also must replace their factories.

that important. Firstly, monopolistic markets (or highly concentrated markets) do not occur that often. Moreover, if they are present, they are either the result of scale economies in production and/or distribution - and hence efficient – or the result of barriers to entry. In the case of barriers to entry, these are merely transitory - the freedom of entry will induce the presence of other players in the market giving them incentives to compete, hence leading to efficiency and limitation of the market power of the initial monopoly. Persistency of market power can only be the result of governmental intervention; sustainable barriers to entry are the results of state monopolies.³¹

2.4 Game Theory & Efficiency

In order to assess an economic analysis of the interdependency in oligopolistic markets, one needs to have sufficient knowledge in game theory. The theory deals with any situation, in which strategy is important. To facilitate the theory, one must first identify the (1) players, (2) the strategies of each player and (3) the payoffs to each player for each strategy. The concept of game theory in oligopolistic markets is best explained with the use of an example, the famous *prisoner's dilemma*³² (this example can be modified to show the individual behavior of players in oligopolistic markets).

		Strategy of Suspect 1	
		Confess	Keep quiet
Strategy of Suspect 2	Confess	-5, -5	-0,5, -7
	Keep quiet	-7, -0,5	-1, -1

Two people, Suspect 1 and Suspect 2, conspire to commit a crime. Having committed the crime, they are apprehended by the police and taken to the police station where they are placed in separate cells, so that they cannot communicate with each other. The authorities question the suspects individually. The prosecutor is aware that the evidence against them is purely circumstantial. If the prosecutor would go to trial with the evidence at hand, the suspects could only be charged with a minor offence, which would give each prisoner one year in prison. Clearly, the prosecutor would prefer one or both of the suspects to confess to the more serious crime that they are thought to have committed. The prosecutor therefore comes up with different more or less lucrative options for the two suspects.

³¹ See Cayseele & Bergh p. 476.

³² See Cooter and Ulen p. 35.

If Suspect 1 confesses and Suspect 2 keeps quiet, Suspect 1 would get half a year in prison and Suspect 2 would get seven years (-0,5, -7); the adverse result would occur if Suspect 1 keeps quiet and Suspect 2 confesses (-7, -0,5). If both suspects keep quiet, they would each get one year in prison (-1, -1). If both suspects confess, they would each get five years in prison (-5, -5). What is the optimal strategy for the two suspects – to confess or to keep quiet?

What would Suspect 1 do if Suspect 2 confesses? If he keeps quiet when Suspect 2 confesses, he will spend 7 years in prison. If he confesses, he will only spend 5 years in prison. If Suspect 2 keeps quiet, the best option for Suspect 1 is undoubtedly to confess. Alternatively, if Suspect 2 keeps quiet, Suspect 1 would spend 1 year in prison if he also keeps quiet and half a year if he confesses. Again, the best option for Suspect 1 is to confess.

In conclusion, regardless of what Suspect 2 does, Suspect 1 will always confess, since this will mean less time in prison for him. Under the *game theory*, confessing will always be the *dominant strategy*³³; confessing will always be the optimal choice, regardless of what the other suspect does. Suspect 2 will come to the same conclusion, namely to confess, since he will go through the same calculations as Suspect 1.

In economic theory, the solution to this game, that both suspects confess, is commonly referred to as the *Nash equilibrium* – an individual player cannot do any better by changing his behavior as long as the other player does not change his. Although the Nash equilibrium is fundamental in the concept of game theory, it is not ‘perfect’. Game theory does not necessarily coincide with *efficiency*; in the *prisoner’s dilemma*, the Nash’s equilibrium calls for both suspects to confess. This is however not the ultimate efficient solution to the problem. When both suspects confess, they will each spend five years in prison. However, there is an option so that both prisoners will spend less time in prison, namely when both suspects keep quiet (for which they will each spend one year in prison). This is referred to as *Pareto efficiency*³⁴, i.e. the most efficient solution for both players. (Interestingly, this solution is impossible to attain since the suspects are held in separate cells, and thus cannot make binding commitments to one another.)

Instead of having two criminal suspects ‘taking’ the test, the prisoner’s dilemma can be applied in oligopolistic markets (the following is an example in a duopolistic market)³⁵:

³³ *Ibid.* p. 37.

³⁴ *Ibid.* p. 12.

³⁵ See Baumol, William J./Blinder, Allen S. (1997) *Economics, Principles and Policy*, 7th edition, p. 290-292.

		Company A's strategy			
		High price	Low price		
Company B's strategy	High price	A: 10	B: 10	A: -2	B: 12
	Low price	A: 12	B: -2	A: 3	B: 3

This is a good example of how oligopolistic markets (can) function. The two upper left boxes indicate that if both companies charge high prices, they will both receive a payoff of 10. The two bottom right boxes indicate that if both companies charge low prices, the payoff will only be 3. If Company A charges high prices and Company B charges low prices, the former will receive a payoff of -2 and the latter will receive a payoff of 12.

Again, what would the strategy of Company A be if Company B charges high prices? If Company A would choose to charge the high price, he would receive a payoff of 10. Alternatively, if Company A would choose to charge the low price he would receive a payoff of 12. The rational strategy for Company A would thus be to charge the low price. Company B would reach the same 'rational' conclusion.

Firms may choose to behave differently depending on various circumstances: Is the duopoly sustainable over time? How transparent is the market in question? Are there any barriers to entry?³⁶ For example, in terms of Pareto efficiency, both companies would always choose the high price strategy, since both companies are better off (here, the total payoff is 20; conversely, if both companies always choose the low price strategy the total payoff is only 6).

Business transactions (like in the example given above) are in reality not a 'one-shot' action, but repeated games. Here it is important to know whether the game will repeat itself for a fixed number of times or indefinitely. Suppose that the game above repeats itself exactly ten times. Depending on what happens in the first game, the two companies will learn by their plausible mistakes. By the second game, the companies would take the strategy that is most efficient. In the example above, both companies would therefore charge high prices (with a total payoff of 20). The companies will stay with this strategy at least until the ninth game, during which either or both companies may decide to change strategy since there is only one game left. Even if the companies have learned to charge the high price through game nine, things will be different in game ten. Because this is the last time the game will be played, Company A has strong incentives to deviate and charge the low price. If Company B charges the high price and Company A changes strategy to the low price in the tenth game, Company A will make an additional payoff amounting to a total payoff of twelve (instead of ten). Company B will of course know that Company A has strong incentives to deviate from the "agreement" and will therefore also charge the low price in

³⁶ These concepts amongst many others will be further explained below.

the final tenth game. Now, Company A has of course already considered this whereby he decides to charge the low price in game nine; Company B, using the same reasoning will therefore also charge the low price in game nine. In the terminology of game theory, the game unravels so that both companies will be charging the lower price every time the game is played if it is to be played a fixed number of times.

On the other hand, if the game will be played an indefinite number of times, neither of the companies has any incentive to deviate from the 'scheme' and will thus always charge the high price.

2.5 Economic Theory in EC Merger Control

The promotion of the internal market continues to be one of the main goals in EC Law. The emphasis in EC Merger Control (as laid down in article 2 of the Merger Regulation) is whether a concentration creates or strengthens a dominant position. The EC rules on Merger Control were founded mainly on political reasons and not so much on economic theory. Market integration has always been and is still highly relevant in EC merger control. This clearly reflects the Harvard School's idea that the structure of the market has an impact on the ultimate performance of the market. There has not until recently (see Section 6 below) been any explicit use of efficiency arguments in EC Merger Control. Instead of treating efficiencies as benefits, which may prevail over anti-competitive consequences, efficiencies have traditionally been seen as evidence of market power.³⁷

The Chicago School's view that efficiency is the only objective to be taken into account in interpreting and applying merger control, never got a firm basis in EC merger control. Rather, as already mentioned, the Harvard School's S-C-P paradigm was applied. Some scholars argue that European antitrust policy is at the same stage of development as the American antitrust policy was in the 1960's³⁸. European merger control has largely lacked an efficiency based approach; neither the European Commission nor the ECJ/CFI has been sufficiently receptive to economic arguments. As a result, decisions and judgments have often been formalistic and based on an expansion of earlier case law. However, in the last few years there has been a shift in the European approach; the ECJ, the CFI and the Commission have commenced to put more emphasis on economic theory. The CFI's judgment in *Airtours* (see section 4 below) and the merger guidelines (see section 6 below) are good examples on the increasing use of economic theory in EC merger control, in particular the use of efficiency.

In sharp contrast to the European approach, American merger policy depends largely on economic arguments. The Chicago School has had a clear influence on the US merger policy. The current 1992 Merger Guidelines is evidence that many of the concepts founded by the Chicago School are now widely used in the US antitrust community. The Guidelines

³⁷ See Cayseele & Bergh, p. 492.

³⁸ Roger van der Bergh, *Modern Industrial Organisation versus Old-Fashioned European Competition Law*, in *European Competition Law Review*, 1996, p. 75-87.

are focused on whether consumers or producers are likely to take certain actions, e.g. whether the ‘action’ is in the actor’s economic interest. This reflects the concern to explain, rather than to describe, behavior in concentrated markets, in order to be able to avoid inappropriate regulatory interventions.³⁹ The goal in US Merger Control is to prevent that prices are raised above competitive levels for a longer period of time, e.g. whether a proposed merger will harmful for consumers⁴⁰.

³⁹ See Cayseele & Bergh, p. 488.

⁴⁰ Ibid p. 489.

3 Case Law Pre-Airtours

3.1 Nestlé/Perrier

Nestlé/Perrier⁴¹ was the first case where the Commission examined collective dominance. Both companies were major players on the French market for bottled water. The merger, whereby Nestlé were to acquire Perrier, would have resulted in that the number of big firms in the relevant market was reduced from three to two. The duopoly (the merged entity and BSN) would have held an almost identical market share and taken together they accounted for more than two thirds of the relevant market (the French bottled water market).

In this case, the Commission established the concept of collective dominance under the Merger Regulation. In its assessment, the Commission concluded the following to be elements leading to a situation of collective dominance, e.g. an early checklist⁴²:

- the reduction of market players from three to two;
- the combined market share of the duopoly accounts for more than 2/3 of the relevant market;
- price transparency;
- the firms are similar in size (e.g. capacity and market share);
- inelastic price demand;
- mature markets; and
- high barriers to entry.

The Commission held that the merger would give rise to reciprocal dependency between the merged parties and BSN and that this would create a platform of common interests in the newly created duopoly. The result of the merger, according to the Commission, would be that the duopoly now had strong incentives to maximize their profits by engaging in anticompetitive behavior⁴³.

3.2 Kali and Salz⁴⁴

The case concerned a proposed joint venture between *Kali und Salz* (K+S) and the *Trehundastalt*, by which the potash and rock-salt businesses of K+S would be combined with those of the former East German producer, Mittelduetsche Kali AG (MdK). Due to high transport costs, an absence of imports and customer preferences among German farmers, the Commission concluded that Germany constituted a distinct geographic market and the

⁴¹ Case IV/M 190 *Nestlé/Perrier* [1992] OJ L 365/1.

⁴² *Ibid.* Para 110-130.

⁴³ *Ibid.* Para 123.

⁴⁴ Joined cases C-68/94 *French Republic v. Commission* and C-30/95 *Société Commerciale des Potasses et de l'Azote (SCPA) and Entreprise Minière et Chimique (EMC) v. Commission*. Judgment delivered on March 31, 1998.

rest of the Community, another. In addressing the geographic market for the community, the Commission found that there was only one other European producer (the French SCPA) engaged in the same type of business as the proposed joint venture between K+S and MdK. The Commission came to the conclusion that, due to the characteristics of the market and the record of past behavior of K+S and SCPA, the proposed transaction would lead to a situation of oligopolistic dominance by K+S/MdK and SCPA⁴⁵.

The Commission emphasized the existence of close links between K+S and SCPA and highlighted the following three issues:

- a potash joint venture in Canada;
- the parties' were members of a cartel established in Vienna to coordinate potash sales outside the Community; and
- K+S used SCPA as an agent in France.

The prohibition decision rendered by the Commission was appealed to the ECJ. For the first time, the ECJ accepted that collective dominance can fall within the scope of article 2 of the Merger Regulation⁴⁶:

".../the basic provisions of the [Merger] Regulation, in particular Article 2 thereof, confer on the Commission a certain discretion, especially with respect to assessments of an economic nature."⁴⁷

".../Consequently, review by the Community judicature of the exercise of that discretion, which is essential for defining the rules on concentrations, must take account of the discretionary margin implicit in the provisions of an economic nature which form part of the rules on concentrations."⁴⁸

However, the ECJ wholly revoked the Commission's decision and held that, in the present case, the Commission had failed to prove that the acquisition of the former East German potash producer MdK by K+S would create or strengthen a position of collective dominance. The ECJ held that the Commission's analysis and assessment did not stand up to rational examination. In this context, the ECJ highlighted that the evidence of structural links between K+S and SCPA brought by the Commission was highly unconvincing.

The judgment delivered by the ECJ is important since it confirms that collective dominance can be assessed under article 2 of the Merger Regulation. At the same time, it can be concluded that the judgment leaves many questions unresolved. The ECJ set a high standard of proof, requiring the Commission to show convincing evidence (as discussed below, the same standard was confirmed in *Airtours*), without giving precise indications on how to tackle collective dominance. The outcome of the *Kali and Salz* judgment did not come as a surprise; up to now, the Commission had engaged in a much too cautious and hasty assessment of collective

⁴⁵ *Ibid.* Para 57.

⁴⁶ *Ibid.* Point 23 of the judgment.

⁴⁷ *Ibid.* Para 223.

⁴⁸ *Ibid.* Para 224.

dominance. The judgment called into question the Commission assessment of collective dominance, and brought forth the need for clarification.

3.3 Price Waterhouse/Coopers & Lybrand

The case concerned the merger of Price Waterhouse and Coopers & Lybrand⁴⁹, two of the companies in the so-called “Big Six” accountancy firms⁵⁰. As mentioned above, the Commission again relied on its “check-list” criteria⁵¹, namely:

- *moderate growth* and
- *inelastic demand* on the **demand side**; and
- *high concentration*;
- *high market transparency*;
- *homogenous products*;
- *mature production technology*;
- *high barriers to entry*; and
- *structural links* on the **supply side**.

The Commission held that as a general principle, collective dominance is unlikely to occur in situations involving more than three or four suppliers because of the complexity in the interrelationships involved, and the consequent ‘temptation’ to deviate⁵². The Commission concluded that such conditions make it difficult to maintain a lasting uncompetitive stability.

Further, the Commission made reference to the ECJ’s earlier judgment in *Kali and Salz*:

“/.../ [The Court] has emphasized that there is a strong burden of proof on the Commission in the case of an oligopolistic market which the Commission holds to be subject to collective dominance.

The Court held that a high level of concentration in an oligopolistic market is not in itself a deciding factor as to the existence of collective dominance. In addition, the Court’s judgment implies that evidence of the lack of effective competition between a group of suppliers held to be collectively dominant must be very strong, as must evidence of the weakness of competitive pressure from other suppliers (if there are any in the market in question).”

⁴⁹ M.1016 *Price Waterhouse/Coopers Lybrand* [1999] OJ L50/27.

⁵⁰ Today, the group is called ‘The Big Five’ and consists of: KPMG, Ernst & Young, Arthur Andersen and Deloitte Touch Tohmatsu.

⁵¹ *Price Waterhouse/Coopers Lybrand* Paras 96-101.

⁵² *Ibid.* Para 103.

3.4 Gencor/Lonhro

The proposed merger between Gencor and Lonhro⁵³ was the first to be blocked on grounds of collective dominance under the Merger Regulation by the Commission⁵⁴ and then upheld in its entirety by the CFI.

The operation involved two companies, Gencor and Lonhro, and the proposed merger of two of their subsidiaries, *Implants* (owned by Gencor) and *Eastplats/Westplats* (owned by Lonhro). The aim of the merger was to bring together the platinum activities of these two subsidiaries. There were three significant competitors all based in South Africa. The result of the merger would have been the reduction from three significant players to two, thus creating a duopoly.

In its economic assessment, the Commission again brought forth the necessary ‘checklist’ for the assessment of collective dominance and came to the following conclusion. On the demand side, there was moderate growth, inelastic demand and countervailing buyer power, making buyers vulnerable to potential abuses. The supply side was highly concentrated. It had high barriers to entry, high sunk costs, high market transparency, mature production technology and structural and financial links. These circumstances taken together gave suppliers the incentive to engage in parallel behavior.⁵⁵ In addition, the Commission concluded that the merger would result in vast symmetries with the remaining two leading firms. They would have had a similar output (approximately 40% of the market each) and similar costs structures⁵⁶. The Commission concluded that these factors (e.g. the characteristics of an oligopolistic market and the absence of asymmetries) were to have reduced price competition on the relevant market significantly; e.g. there would no longer be any incentives for the two firms forming the duopoly to compete with each other.

The CFI held that retaliatory measures (i.e. a punishment mechanism that comes into action if one of the firms fails to comply with the common policy) in oligopolistic markets is a strong factor in assessing whether there will be an enhanced collusive outcome⁵⁷:

*“Price transparency is a fundamental factor in determining the level of market transparency where there is an oligopoly. By means of the price mechanism, the members of an oligopoly can, in particular, immediately discern the decision of other members of the oligopoly to alter the status quo by increasing their market share and they make such retaliatory measures as may be necessary in order to frustrate actions of that kind”*⁵⁸.

⁵³ T-102/96 *Gencor v Commission* [1999].

⁵⁴ M. 619 *Gencor/Lonhro* [1996] OJ C 314.

⁵⁵ *Gencor/Lonhro* Para 164.

⁵⁶ The proposed merger of one low-cost producer and one high-cost producer would have resulted in similar cost structure compared with *Amplants*, the remaining firm on the market.

⁵⁷ The Commission did not emphasize these criteria. It merely pointed out that it can be a possible market conduct.

⁵⁸ *Gencor v Commission* Para 227.

The main issue in the context of collective dominance in the CFI's judgment in *Gencor/Lonhro* is whether, as a result of a merger, there are factors making it easier for the remaining firms to engage in parallel anti-competitive behavior. In the present case, especially in the light of game theory, the rational choice for the remaining firms would have been to engage in anti-competitive behavior. This was recognized by the CFI: “[anti-competitive parallel conduct] *would, economically, have constituted a more rational strategy than competing with each other, thereby adversely affecting the prospect of maximizing combined profits*”⁵⁹. Important in the CFI's decision is that the typical characteristics of an oligopolistic market (the ‘checklist’) do not as such, amount to anticompetitive collusive behavior in oligopolistic markets. The CFI concluded that certain measures are necessary for tacit coordination to be sustainable over time. Without retaliatory measures, firms will be tempted to deviate from the common policy and engage in secret discounts or selective price shading in order to maximize their profits.

⁵⁹ *Gencor v Commission* Para 236.

4 AIRTOURS

The case concerned an appeal by Airtours from a Commission decision⁶⁰ prohibiting the company's hostile take-over-bid of First Choice. The two companies were leading players in the UK market for short-haul foreign package holidays. Airtours' main competitors in the UK were Thomson, Thomas Cook and First Choice. The proposed transaction was notified to the Commission on 22 September, 1999. The Commission blocked the proposed merger as incompatible with the common market. This was on basis that it would lead to the creation of a dominant position in short-haul package holidays in the UK; the Commission held that a collective dominant position would be held by Airtours/First Choice and the remaining two leading tour operators, Thomson and Thomas Cook. The Commission found that the three tour operators would increase their joint market share from 68% to 80%.

The Commission was concerned that the merger would lead to that the newly merged company together with the remaining two firms would engage in tacit coordination (tacit collusion), thus creating a collective dominant position. The underlying idea behind tacit coordination is that separate firms can achieve a common approach to the market by reaching the same conclusions independently through their readings of a shared business environment and expectations of the actions of other players on the market. The common policy is "tacitly" shared without being actively deliberated upon in any collective manner. The Commission feared that the merger would lead to that effective competition on the European market would be significantly impeded, resulting in higher prices than those which would exist if there was effective competition. Moreover, the Commission found that small operators would be further marginalized as a result of the new market structure.

4.1 The Judgment Rendered by the CFI⁶¹

The appeal made by Airtours composed of four components⁶²:

1. the Commission had incorrectly identified the relevant products market;
2. the Commission had breached the principle of legal certainty by inventing a new and incorrect test for assessing collective dominance;
3. the Commission had erroneously found a situation of collective dominance;
4. And the failure to accept the proposed undertakings made by Airtours was disproportionate.

⁶⁰ Airtours/First Choice, Case IV/M.1524, [2000] OJ L93/1

⁶¹ T-342/99 *Airtours v. Commission* [2002]

⁶² *Ibid.* Para 16.

With regards to the first plea, the CFI held that in order to assess how a merger will affect competition on the Internal Market, it is necessary to identify the relevant product market⁶³. In the present case, however, the CFI noted that the Commission had made a correct assessment of the relevant product market⁶⁴. The CFI largely ignored pleas (2) and (4)⁶⁵ and concentrated on the third issue, e.g. the Commission had erroneously found a situation of collective dominance.

The CFI first held that the Commission, when finding it necessary to block a merger, must produce convincing evidence, “*justifying the decision*”⁶⁶. The CFI then turned to the type of evidence the Commission had presented in the *Airtours* decision. The CFI concluded that far from being based on convincing evidence, the Commission had based its decision on “*a series of errors of assessment as to factors fundamental to [...] whether a collective dominant position might be created*”⁶⁷.

The CFI developed and clarified the concept of collective dominance: “*A collective dominant position significantly impeding competition in the common market or a substantial part of it may thus arise as the result of a concentration where, in view of the actual characteristics of the relevant market and of the alteration in its structure that the transaction would entail, the latter would make each member of the dominant oligopoly, as it becomes aware of common interests, consider it possible, economically rational, and hence preferable, to adopt on a lasting basis a common policy on the market with the aim of selling at above competitive prices, without having to enter into an agreement or resort to a concerted practice within the meaning of Article 81 EC [...] and without any actual or potential competitors, let alone customers or consumers, being able to react effectively*”⁶⁸.

For the first time, the CFI acknowledged three criteria that must be at hand for a finding of collective dominance, a so called tripartite test⁶⁹:

First, there must be sufficient market **transparency** for each member of the dominant oligopoly to be able to know how the other members are behaving in order to monitor whether or not they are adopting a common policy. “*As the Commission specifically acknowledges, it is not enough for each member of the dominant oligopoly to be aware that interdependence market conduct is profitable for all of them but each member must also have a means of knowing whether the other operators are adopting the same strategy and whether they are maintaining it. There must, therefore, be sufficient market transparency* [emphasis added] *for all members of the*

⁶³ *Ibid.* Para 19.

⁶⁴ *Ibid.* Para 19-48.

⁶⁵ These points were deemed irrelevant in the present case.

⁶⁶ *Airtours v Commission* para 63.

⁶⁷ *Ibid.* Para 294.

⁶⁸ *Ibid.* Para 61.

⁶⁹ *Ibid.* Para 62.

dominant oligopoly to be aware, sufficiently precisely and quickly, of the way in which the other members' market conduct is evolving"⁷⁰.

Second, there must be adequate retaliatory measures (i.e. **punishment mechanisms**) to ensure that tacit coordination is sustainable over time so as to prevent cheating. "[...] *it is only if all members of the dominant oligopoly maintains the parallel conduct that all can benefit. The notion of retaliation in respect of conduct deviating from the common policy is thus inherent in this condition. [...] for a situation of collective dominance to be viable, there must be **adequate deterrents** [emphasis added] to ensure that there is a long term incentive in not departing from the common policy, which means that each member of the dominant oligopoly must be aware that highly competitive action on its part designed to increase its market share would provoke identical action by the others [...]*"⁷¹.

Third, the Commission must also establish that the parties' tacit coordination would not be undermined by current and future competitors, as well as of customers (i.e. **competitive fringe**).⁷²

Having clarified the criteria necessary to be at hand in order to establish a situation of a collective dominant position, the CFI, on basis of the tripartite test, examined the Commission's assessment in the present case.

4.1.1 Transparency

The CFI concluded that the market for short-haul foreign package holidays was neither sufficiently transparent nor conducive to foster tacit coordination. With regards to the main operators' market shares, the CFI disagreed with the Commission's assertion that the market was broadly stable and held: "*there is no justification [...] for excluding growth by acquisition when assessing the volatility of market shares*"⁷³. It became evident that when including such growth in the present case, market shares were clearly volatile, giving a clear indication that the relevant product market was competitive.

The CFI accepted Airtours view that the market was not sufficiently transparent to cultivate tacit coordination, in particular due to the problem of capacity determination. Determining capacity is not a mechanical exercise, which renews itself from one year to the next, but rather a "*[...] very complex task, which takes historical data into account only to a limited extent and which is based primarily on a subjective assessment by each operator by reference to a whole range of variables and factors.*"⁷⁴

Moreover, the CFI held that the Commission had failed to prove that the tour operators were sufficiently able to monitor decisions taken by competitors. The CFI concluded that the major tour operators did not always

⁷⁰ *Ibid.* Para 62.1.

⁷¹ *Ibid.* Para 62.2.

⁷² *Ibid.* Para 62.3.

⁷³ *Ibid.* Para 113.

⁷⁴ *Ibid.* Para 160.

use the same hotels. Even where the same hotels were used, tour operators would have difficulties obtaining relevant information from the hotel owners; this was explained by the hotel owners' concern to guard against a possible decline in demand from the tour operators themselves or a general decline in demand for the resort.⁷⁵

Furthermore, the CFI highlighted the difficult task of maintaining transparency in the event that business would decline. Generally, it is much more difficult to detect and interpret decisions to reduce business, than decisions to expand it.⁷⁶

With respect to the use of air fleets, the CFI held that decisions are taken at a very late stage in the planning; generally at the same time as the brochure is published, i.e. 12 months before the start of the season⁷⁷. Moreover, Airtours did not, to a significant degree, depend on other major tour operators for the purchase of airline seats⁷⁸. The CFI therefore concluded that the level of negotiation between the major tour operators to obtain or supply capacity or arrange swaps of seats did not amount to a sufficient degree of transparency⁷⁹.

In conclusion, the CFI did not believe that the present circumstances could foster tacit coordination, and in any event, the Commission had not proven otherwise.

4.1.2 Retaliatory Measures

Hereafter, the CFI examined tacit coordination in light of retaliatory mechanisms. It noted that the Commission had adopted an 'ambiguous approach' in this regard. The Commission had in its decision stated that retaliatory measures were not a necessary condition for collective dominance; it further held that there was considerable scope for retaliation in the market in question, which only would increase the incentives to engage in anti-competitive behavior⁸⁰.

The CFI strongly opposed this: "[...] *the Commission must not necessarily prove that there is a specific retaliation mechanism involving a degree of severity, but it must nonetheless establish that deterrents exist*"⁸¹. Moreover, the deterrents must be sufficiently strong so as to hinder the firms from deviating from the common policy, e.g. it should be more profitable to stay with the common policy.

In addressing the Commission's view that there already was considerable scope for retaliation in the market, the CFI emphasized that retaliation mechanisms must be sustainable over time. It also highlighted the close links between retaliatory measures and transparency. "[...] *in a case of [...]*

⁷⁵ *Ibid.* Para 173.

⁷⁶ *Ibid.* Para 176.

⁷⁷ *Ibid.* Para 177.

⁷⁸ *Ibid.* Para 178-179.

⁷⁹ *Ibid.* Para 179.

⁸⁰ Airtours/First Choice, Case IV/M.1524, [2000] OJ L93/1 Para 55 and 150.

⁸¹ *Airtours v Commission* Para 195.

*cheating (where, for example, during the planning period one of the main tour operators attempted to turn to its advantage the overall capacity restriction resulting from parallel anti-competitive conduct), the other members of the oligopoly would find it difficult to detect the deviation because the market is not sufficiently transparent [...]*⁸². In the event that the members would detect deviation, retaliation would neither be sufficiently rapid, nor efficient.⁸³

4.1.3 Competitive Fringe

The last ‘attack’ on the Commission’s decision concerned the potential counterbalance offered by consumers and competitors to the market power of the alleged dominant group. The CFI held that it is irrelevant whether a small tour operator effectively can compete and reach the same size as the major tour operators⁸⁴. What is important is whether “ [...] *the hundreds of small operators already present on the market, [...] can correspond effectively to a reduction in capacity put on to the market by the large tour operators to a level below estimated demand [...] and thereby counteract the creation of a collective dominant position*”⁸⁵.

The CFI made a substantial investigation on the capabilities of the smaller operators and found convincing evidence that these firms would be quick in taking advantage of the opportunities given by any undersupply on the market⁸⁶. It thus became clear that a large part of the Commission’s arguments became immaterial⁸⁷.

Together with other aspects brought by the CFI, the outcome of the case resulted in the annulment of the original decision of the Commission.

4.2 The Judgment’s Deficiency

The outcome of the Airtours case was appropriate in the circumstances; the Commission’s assessment of tacit coordination in the market for foreign package holidays was fundamentally wrong. However, to a certain extent, the CFI was perhaps too eager to come up with a desirable result and thus shaped its interpretation in order to reach the ‘correct’ outcome.

The most important deficiency of the judgment deals with the increased burden of proof⁸⁸, making it practically impossible for the Commission to prohibit mergers based on collective dominance.

The Airtours judgment was of tremendous importance regarding the CFI’s increased strict standard of substantiation and evidence regarding the finding of collective dominance. This is however nothing new. The CFI and

⁸² *Ibid.* Para 198.

⁸³ *Ibid.* Para 203.

⁸⁴ *Ibid.* Para 213.

⁸⁵ *Ibid.*

⁸⁶ *Ibid.* Para 217-269.

⁸⁷ *Ibid.* Para 214.

⁸⁸ Standard of Proof is treated separately in Section 6 below.

the ECJ had in its earlier case law established a high burden of proof, which the Commission in its own decisions later acknowledged⁸⁹. Despite the Commission's recognition of the high standard of proof laid upon them, the CFI still did not think that the Commission's efforts had been enough. At para 127 of the judgment, the Court held that "[...] *the Commission's findings are based on an incomplete and incorrect assessment of the data submitted to it during the administrative procedure*".

It can be argued that the CFI exceeded its authority under Article 230 of the EC Treaty in the exercising of its review function; the CFI may have gone too far into the merits of the Commission's evaluation. In order to assess collective dominance, it may be necessary to have a high evidential threshold. However, such high burden of proof will make the Commission's economic analysis to start to resemble strict predictions, which, if appealed, can be easily overturned by the CFI. And in order for the CFI to overturn such decisions, it needs to engage in substantive investigations, which may go beyond the power of the Court.

4.3 Conclusions

Undoubtedly, the judgment delivered by the CFI in the Airtours case has been of tremendous significance in the alignment of future EC Merger Control. Most importantly, there is now an explicit tripartite test for the assessment of collective dominance. The magnitude of transparency of the market, the need for retaliatory measures and the potential influence of competitors and consumers has at prima facie created legal certainty and adequate guidance for the future.

Despite the clarity the judgment provides, it calls into question the future existence of collective dominance. It is true that there is an explicit tripartite test in order to establish the existence of a possible collective dominant position. Inherent in the tripartite test is a new ambiguous increased standard of proof. This can be exemplified by the following: In Para 195 of the Airtours judgment, the CFI held that the Commission did not necessarily have to prove the existence of a 'specific retaliation mechanism involving a degree of severity'. Nonetheless, it must prove that a 'non-specific deterrent' makes it unfavorable for oligopolists to cheat! How can the Commission present 'convincing evidence' that cheating is not worthwhile without identifying a specific retaliatory mechanism and explaining how it works?

Nevertheless, the deepened burden of proof, including an exceedingly complex prospective economic analysis, is starting to resemble that of a pure economic prediction. As a result, such predictions can, as in the Airtours case, be easily overturned by the CFI, leaving collective dominance

⁸⁹ In *Price Waterhouse/Coopers Lybrand* the Commission held: "[...] *the Court's judgment [in Kali and Salz] implies that evidence of the lack of effective competition between a group of suppliers held to be collectively dominant must be very strong, as must evidence of the weakness of competitive pressure from other suppliers (if there are any in the market in question).*"

as 'no longer a concept in EC Merger Control'. Only in the most obvious cases can collective dominance 'survive'.

The Airtours case failed to give a proper explanation on what amounts to sufficient evidence in order to establish a position of collective dominance. This leaves the Commission (and the industry) without guidance on this decisive issue. It appears that the only way to bring collective dominance back as a concept would be to explicitly determine the level of standard of proof.

5 STANDARD OF PROOF

“The contested decision does not in itself establish to the **requisite legal standard**⁹⁰ [emphasis added] that the [...] merger would give rise to significant anti-competitive [...] effects”⁹¹. The citation is from the Tetra Laval case, but the same conclusion was reached by the CFI in three consecutive merger cases⁹². In the named cases, the CFI considered that the Commission’s decisions lacked convincing evidence and thus did not hesitate to overturn the Commission’s prohibitions. The cases raise an important issue: what standard of proof must the Commission present for the CFI to consider it to be in line with the Merger Regulation? The standard of proof is important in (at least) two ways⁹³:

1. the standard of proof may have a critical bearing on the outcome of an appeal; and
2. it is a source of guidance for both the Commission and the notifying parties.

The outcome of a notified merger, e.g. whether it is cleared, investigated in-depth, subject to commitments or prohibited by the Commission, is primarily subject to how the standard of proof is understood by the CFI and ultimately, by the ECJ. In simplified terms, the standard of proof determines if the Commission has proved its case.

Although the wording by the CFI in *Airtours*, *Tetra Laval* and *Schneider* remained largely the same, it can be argued whether the judgments indicate a departure from the way standard of proof has been applied in earlier case law. This thesis has in *Section 4 Airtours* argued that the standard of proof has been raised; the CFI stated that “[the Commission must] *produce convincing evidence*”⁹⁴. Without such evidence, a merger will be cleared and a Commission decision will be overturned.

In *Tetra Laval*, the CFI held that the Commission’s analysis of the future market must be “particularly plausible”⁹⁵. Similarly, in *Schneider* the CFI held that the Commission must present sufficient evidence so that the CFI can conclude that both arms of Article 2(3) of the Merger Regulation have been satisfied⁹⁶.

Due to the defeats suffered by the Commission in the above named cases, it has recognized the importance of the clarification of standard of proof and thus decided to appeal the *Tetra Laval* judgment⁹⁷. In the Commission Press

⁹⁰ See also *Airtours*, Para 294.

⁹¹ Case T-5/02 *Tetra Laval v Commission* [2002] Para 336.

⁹² In addition to *Tetra Laval: Airtours v Commission* and Cases T-310/01 and T-77/02, *Schneider Electric v. Commission* [2002].

⁹³ See David Bailey, *Standard of Proof in EC Merger Proceedings: a Common Law Perspective* [Common Market Law Review, 40, 2003], p. 845.

⁹⁴ *Airtours v Commission* Para 63.

⁹⁵ *Tetra Laval v Commission* Para 162.

⁹⁶ *Schneider Electric v Commission* Para 412.

⁹⁷ C-12/03 *Commission v Tetra Laval* (pending).

Release that followed the appeal in the Tetra Laval case, the Commission held that the standard of proof imposed by the CFI is disproportionate with regard to the principle of legality under Article 230 of the EC Treaty and impossible to apply in practice. This is an interesting statement. For the first time, the Commission indirectly ‘confessed’ that due to the unfeasibility to obtain an adequate standard of proof, the Commission will not be able to prohibit mergers based on (collective) dominance⁹⁸.

There are several issues that may arise in this appeal⁹⁹ making it very interesting to follow:

1. What is meant by the standard of proof in EC competition law in general and in EC merger Control in particular?
2. What is the standard of proof currently applied by the CFI/ECJ in merger cases?
3. What should an appropriate standard of proof be?

5.1 The Concept

What is implied with *standard of proof*? In both criminal and civil proceedings, a court decides whether an event, de facto, has taken place or is likely to happen on basis of standard of proof. The court will look at the amount, type and value of the evidence presented in order to assess whether an alleged past event or an alleged future event has been established. Most jurisdictions have set up, in their legislation, various thresholds, so as to indicate the minimum level of standard of proof to be presented.

Neither the EC Treaty, nor the Merger Regulation makes any reference to the standard of proof to be applied in merger cases. The closest we get to an explicit reference point in EC competition policy is the commonly used concept established in case law by the CFI and the ECJ: “*requisite legal standard*”¹⁰⁰. This ‘legal standard’ involves a great deal of uncertainty, since it has not been further developed; it is merely something the Courts refer to. This is worrying for two reasons: (1) a vague and imprecise standard of proof challenges the correctness of the conclusions reached and (2) the application of standard of proof can vary from case to case due to the ambiguity of the concept.

The concept of standard of proof is particularly important in merger cases; based on the Commission’s fact-finding and prospective analysis, the standard of proof will determine whether the CFI or the ECJ upholds or annuls a Commission merger decision. It is thus necessary to lay down clear

⁹⁸ In Tetra Laval, the main issue was whether the takeover of Sidel would lead to the creation of a dominant position, and not collective dominance. However, both Tetra Laval and Airtours were decisive on the question of evidence, e.g. the Commission’s inability to present convincing evidence, making the Commission statement in Tetra Laval highly relevant.

⁹⁹ Bailey, p. 847.

¹⁰⁰ For example, see *Airtours v Commission* Para 294 and *Tetra Laval v Commission* Para 336.

rules for the application of the ‘requisite legal standard’ so that the Commission (and the industry) will know when a merger should be cleared, attached with commitments or prohibited. The outcome of the Tetra Laval appeal is therefore of utmost importance.

In EC merger control, the burden of proof rests on the Commission. It must show why a merger is incompatible with the common market¹⁰¹. Clearly, the burden of proof lies on the Commission in its own proceedings, but what the CFI appears to imply is that the Commission must also convince the Court that its decision was lawful. Interestingly, this is contrary to the generally accepted norm that it is the person bringing the appeal who should bear the burden of proof.

In any legal system, the standard of proof depends to a large extent, on the seriousness of the offence and the possible punishments that will be imposed. A high standard, such as ‘proof beyond reasonable doubt’ typically applies in criminal proceedings. Other situations call for a lower standard of proof. In any situation, the main concern is to ensure an appropriate balance between private and public interests while keeping the law at a workable condition.

5.2 Current Standard of Proof Applied in EC Merger Control

The CFI’s judgments in *Airtours* and *Tetra Laval* both held that the Commission’s appraisal of a merger in relation to collective dominance (*Airtours*) and conglomerate effects (*Tetra Laval*) must be based on ‘convincing evidence’¹⁰². The CFI held that the Commission must ensure that both arms of Article 2(3) of the Merger Regulation have been met. To require ‘convincing evidence’ must be considered as a high standard of proof. It can be argued that the CFI found it necessary to require a higher standard of proof due to the problem of sustainable tacit coordination in *Airtours* and prospective conglomerate anticompetitive effects in *Tetra Laval*. However, it can also be argued that the standard of proof should not vary according to the effects that a merger might have; rather it remains the same for all cases¹⁰³. In the *Tetra Laval* case, the CFI held that the Commission must not necessarily prove that a dominant position will be created or strengthened immediately after the merger. Instead, the CFI laid down a new and valuable principle in recognizing that the Merger Regulation applies where the Commission can show that negative effects on competition would be likely to occur in the relatively near future¹⁰⁴.

Although the CFI and the ECJ has consistently applied the ambiguous concept ‘requisite legal standard’ in its merger cases, it appears *beyond reasonable doubt* (!) that the recent three merger judgments have in fact set a significantly higher standard of proof.

¹⁰¹ *Airtours v Commission* Para 77.

¹⁰² *Ibid* Para 63 and *Tetra Laval v Commission* Para 155.

¹⁰³ Bailey, p. 859.

¹⁰⁴ *Tetra Laval v Commission* Para 153.

Mario Monti, in a speech at the International Bar Association in Brussels 2002, certainly seemed to think that the level of standard of proof had been raised: “*The Commission [...] has faced unprecedented criticism in the wake of the three judgments of the Court of First Instance over-turning on appeal the prohibitions decisions we had taken in Airtours/First Choice, Schneider/Legrand and Tetra Laval/Sidel. [...] it is clear that the CFI is now holding us to a very high standard of proof, and this has clear implications in the way we conduct our investigations and draft our decisions*”¹⁰⁵.

Moreover, in the Press Release that followed the Tetra Laval appeal, the Commission even went as far as to say that the “ [...] *CFI had imposed a disproportionate standard of proof for merger prohibition decisions. [...] The Commission believes that [the level of proof imposed by the CFI] is impossible to meet in practice and is inconsistent with the objectives of the Merger Regulation*”¹⁰⁶. The Press Release, in very clear wording, expresses the Commission’s view that, as the case law stands today, it is impossible to prohibit a merger on basis of a (collectively held) dominant position¹⁰⁷.

5.3 An appropriate Standard of Proof

The discussion above has largely concerned the CFI’s rulings in Airtours and Tetra Lava and whether the CFI hereby has raised the standard of proof. Assuming that the standard of proof has been raised, it is of utmost importance to identify exactly what the new standard is. Failing to do so, legal uncertainty will follow, both for the merging parties and the Commission. The following intends to show, on the one hand, the emerging need of an explicit formula and on the other, the exceedingly complicated task in creating such a formula in EC Merger Control.

It is important to differentiate between *past and future events*, e.g. the difference between proving present (and past) facts and predicting future events. Competition concerns under Article 81 and 82 of the EC Treaty are fundamentally different with regards to the standard of proof under the Merger Regulation. To determine something that has happened in the past is very different from merger cases where evidence must be presented to predict future competitive effects. To investigate the likelihood that a merger would result in distorted competition in the future must be based on plausible conclusions that can be drawn from the existing situation. Such a prospective economic analysis could only give a certain level of indication as to whether the merger would have negative effects on competition. The level of inaccuracy on such analysis will, in most cases, be rather high.

¹⁰⁵ Mario Monti, speech at the International Bar Association in Brussels, 7 November 2002. For full text, see: www.ibanet.org/pdf/mario_monti_speech.pdf.

¹⁰⁶ Commission Press Release IP/02/1952, 20 December 2002.

¹⁰⁷ Even though the Tetra Laval judgment involved the possible finding of the creation of a dominant position, and not a collectively held dominant position, both judgments are highly relevant with regards to the question of standard of proof and the quantity and quality of evidence that must be presented.

The problem with expressing the standard of proof in terms of probabilities is that borderline cases are as likely to go one way as the other. This problem underlines what is implicit in any merger cases, namely that there is always a degree of uncertainty in making a decision. Furthermore, it is impossible to plot a 'mathematical formula' to show firms' behavior in the market.

One of few certainties is that a merger will always leave uncertainties as to the transaction's precise impact on competition. The question remains: who should benefit from the conclusions to be drawn from the existing market conditions in predicting the merger's impact on the future?

One of the fundamental objectives of the Merger Regulation is to ensure that competition on the internal market is not distorted. This can be interpreted as giving the Commission the benefit of the doubt; on basis of the Merger Regulation it is far worse to give clearance to a merger that would harm the market structure than prohibiting a harmless merger¹⁰⁸.

On the other hand, merging parties could argue that there is a fundamental right to engage in economic activities. Article 2(3) of the Merger Regulation is not a directly applicable prohibition; if the Commission's prohibition decision leaves sufficient margin of doubts as to the merger's negative impacts on competition, it should be cleared as a matter of principle. The merging parties would moreover substantiate their case by providing examples from the CFI's judgments in *Airtours*, *Tetra Laval* and *Schneider*: the CFI required *convincing evidence*. In addition, the Commission's decisions were considered *manifest errors*.

In conclusion, a specific and appropriate standard of proof needs to be established in the field of EC Merger Control. This can be accomplished by introducing a section about evidence in the recital of the new Merger Regulation. Alternatively the Commission can either insert a section on evidence in the merger guidelines or issue a Notice on the standard of proof in merger cases. Regardless of the alternative chosen, the Commission should first wait for the ECJ's ruling on the *Tetra Laval* appeal, and on basis of the judgment, make the appropriate proposals. As held above, such standard can most likely not amount to perfection, but it will nonetheless lead to improved legal certainty.

¹⁰⁸ Merger Regulation Recitals 6 and 7 and Article 3(1) g of the EC Treaty.

6 CHANGES IN EC MERGER CONTROL

On 11 December 2002, the Commission adopted a package of measures that would make important substantive and procedural changes in the EC merger control regime¹⁰⁹. It consists of three parts: (1) a proposal for Council regulation replacing the present Merger Regulation, (2) draft “Best Practice” guidelines aimed at improving the parties’ right of defense and the Commission’s decision-making process and (3) a draft notice on the assessment of horizontal mergers¹¹⁰ (the ‘merger guidelines’). The reform came partly as a result of the Commission’s humiliating defeats in *Airtours*, *Tetra Laval* and *Schneider*. The proposed guidelines and the process reforms are an important step towards bringing more analytical rigor into the merger review process and improving the Commission’s fact-finding and evaluation of mergers. The following will largely concentrate on the merger guidelines. Before that, there will be a general outline of the restructuring of DG Competition, e.g. the Commission’s working methods.

Apart from the above-mentioned substantial changes, the Commission has decided to fundamentally change DG Competition, the department responsible for anti-trust and merger cases. The restructuring comprises the following elements¹¹¹:

- 1. The appointment of a Chief Economist in charge of a specialist economist unit.** This was introduced in order to increase the economic rigor in the Commission’s decisions. The Chief Economist will have a staff of 10 economists who will help in providing technical input to case-handlers, and critically scrutinize their conclusions;
- 2. Systematic peer panel reviews.** The purpose of this introduction is the same as for the Chief Economist, namely to have an independent internal review, testing the Commission’s conclusions. The panel is set up on an ad hoc basis, and members are drawn from both DG Competition and other DGs. The intention is for these panels to be activated in phase two investigations;
- 3. Strengthening of the role of Hearing Officer.** It has traditionally been the Hearing Officer’s role to ensure that merger investigations are conducted in a fairly and proper manner, so that the parties’ rights of defense are respected. The role was introduced in 1986, and

¹⁰⁹ See Commission Press Release IP702/1856 of 11 December 2002.

¹¹⁰ *Commission Notice on the appraisal of horizontal mergers under the Council Regulation on the control of concentrations between undertakings*, OJ 2002 C 331/18.

¹¹¹ It is yet to see what impact these changes will have. The following is merely an outline of the changes of which most will come into effect I May 2004.

the general consensus amongst competition lawyers in Brussels¹¹², has been that the efficacy of these Officers have significantly decreased over the years. The idea is thus to make available additional resources to Hearing Officers so that their roles are strengthened;

- 4. The disbandment of the Merger Task Force (“MTF”), instead re-organizing DG Competition into smaller sectoral units.** The MTF will be fully disbanded and replaced by sectoral directorates. These will be divided into the following industries: (1) *Information, Communication and Media* (post, information society, media and consumer electronics), (2) *Services* (banking and insurance, transport and other services), (3) *Industry and Energy* (chemicals minerals, petrochemicals, metals and steel and other industries) and (4) *Consumer Goods* (consumer goods and agriculture, motor vehicles and other means of transport, food and pharmaceuticals). The four merger units will only deal with cases relating the sectoral directorate’s specific industries. As of 1 May 2004, these sectoral units will handle not only mergers, but be integrated with all cases (mergers, abuses of dominant positions and cartels).

On 27 November 2003, the Member States of the EU reached unanimous agreement to reform the dominance test in Article 2(3) of the Merger Regulation. The current test prohibits a merger if it ‘creates or strengthens a dominant position as a result of which effective competition would be significantly impeded’. The new test, which comes into effect on 1 May 2004, prohibits mergers that “*significantly impede effective competition [...] in particular as a result of the creation or strengthening of a dominant position*”.

Before the Council adopted the new test, there were talks on whether to adopt the ‘substantial lessening of competition test (SLC), as used in the United States, the United Kingdom, Australia, New Zealand among others. The SLC test focuses on the likely economic outcome of the merger rather than on market structure. A possible adoption of the SLC test faced resistance from practitioners and Member States, who argued that such a change would jeopardize the legal certainty created by the existing dominance test. The result is a transformed dominance test with similarities to the SLC test.

In view of the new test, it appears clear that collective dominance is now explicitly comprised for scrutiny under the Merger Regulation.

6.1 The Merger guidelines

The merger guidelines are the first in a series of guidelines in the Commission’s analysis in merger investigations¹¹³. The current merger

¹¹² Discussion with P. Alexiadis, partner at Gibson Dunn & Cruthers LLP and Rebecca O’Donnell, partner at Squire Sanders & Dempey LLP, May 20 2003, both coming to the same conclusion.

¹¹³ Draft guidelines on vertical and conglomerate mergers will be published early in 2004.

guidelines are more in conformity with the US approach. Interestingly, the guidelines embrace an increasingly deeper economic analysis, e.g. a shift from the Harvard School's S-C-P paradigm approach to the Chicago School approach¹¹⁴. With regards to collective dominance, the Commission has recognized the principles laid down by the CFI in the Airtours judgment. The following intends to give a detailed analysis on, particularly, collective dominance as explained in the merger guidelines. Where appropriate, comparisons will be made with the US guidelines Horizontal Mergers. In addition, this section aims at showing the merger guidelines' deficiencies where one can distinguish a need for clarification and/or improvement.

6.1.1 Dominance Test

The merger guidelines identify three ways, in which horizontal mergers may have anti-competitive effects¹¹⁵:

1. *A firm with a paramount market position* – such firms may be in a position to increase prices without being constrained by actions of its customers and its actual or potential competitors;
2. *Non-collusive oligopolies* – such mergers may eliminate important competitive constraints on one or more sellers, who consequently would be able to increase prices; and
3. *Collusive oligopolies* – a merger in an oligopolistic market may change the nature of competition. Sellers may, on basis of a merger, be given the incentive to tacitly commence to coordinate their behavior, which ultimately would result in higher prices for consumers.

For the purpose of this thesis, I will concentrate on (3), e.g. collective dominance.

6.1.2 HHI-Index

The merger guidelines hold that market shares often provide a first indication of the competitive importance of the merging companies and that of its competitors¹¹⁶. In order to assess the preliminary indication of competitive pressure in post-merger markets, the Commission will apply the Herfindahl-Hirschman Index ('HHI')¹¹⁷. The HHI is calculated by adding the squares of the individual market shares of all the firms in the market. A market with four firms with market shares of 40%, 25%, 20% and 15%, has a HHI of 2850 ($40^2+25^2+20^2+15^2$). The Commission would preferably include all firms' market shares, but acknowledges that small firms (less than 5%) will not alter the HHI significantly. The index gives proportionately greater weight to the larger firms, thus in line with the

¹¹⁴ See section 2 *Economic Theory* above.

¹¹⁵ Merger guidelines Para 11.

¹¹⁶ Merger guidelines Para 14.

¹¹⁷ *Ibid.* Para 16.

purpose of the test. The Commission is unlikely to investigate cases with an HHI of less than 1000.

6.1.2.1 Deficiencies

The merger guidelines' explicit use of the HHI as a means of providing a first general indication of the concentrated nature of market(s) concerned is a welcomed initiative¹¹⁸. However, a few points at issue are questionable and must therefore be highlighted. Firstly, it adopts a potentially inflexible approach, which suggests that the Commission automatically will open an in-depth investigation where a post merger HHI level amounts to 2000 or more¹¹⁹. This would comprise too many markets; an in-depth investigation would be initiated whenever a company with a market share of 40-50% intend to merge with a company of >5%. Besides the fact that this would entail excessive costs both for the commission and the merging parties, it also goes contrary to Point 13 and 14 of the guidelines where it is held that market shares should only be regarded as a first indication of how competition will be affected as a result of a merger.

The Commission is unlikely to start an in-depth investigation where the HHI post-merger remains below 1000¹²⁰. This is a very low threshold – certainly there are mergers resulting in a HHI level of more than 1000, but all the same are unlikely to give rise to anti-competitive concerns. An alternative would be to take into consideration both the post-merger HHI and the increase in the HHI, as provided for in the US Horizontal Merger Guidelines¹²¹.

Lastly, in para 20 of the merger guidelines, it is held that market shares in excess of 50% may be, in themselves, evidence of the existence of dominant market position. This is not only contrary to sound economic analysis, but it also contradicts the guidelines' approach in para 14, where it is held that market shares should only be a first indication of the competitive importance of both the merging parties and their competitors.

6.1.3 Collusive Oligopolies

The merger guidelines' section on collusive oligopolies is the first piece of legislative material that explicitly deals with collective dominance and came as a direct response to the Airtours judgment¹²². Para 40 of the guidelines give a general definition to the concept of collective dominance:

“A merger may change the nature of competition in an oligopolistic market so sellers, who previously were not

¹¹⁸ See the various results for the invitation for comments concerning the merger guidelines, www.europa.eu.int/comm/competition/mergers/review/contributions.html.

¹¹⁹ Merger guidelines Para 27.

¹²⁰ Merger guidelines Para 16.

¹²¹ US Horizontal Merger Guidelines Para 1.51.

¹²² Explicit references are made to Airtours judgment in several places, see the merger guidelines footnotes 34 and 36.

coordinating their behavior, are now able to coordinate and thus raise their prices, without having to enter into an agreement or resort to a concerted practice within the meaning of Article 81 EC. The alteration of the market structure may be that they would consider it possible, economically rational, and hence preferable, to adopt on a lasting basis a course of action on the market aimed at selling at above competitive prices.

The Commission adopted the three basic conditions as laid down by the CFI in *Airtours*. First, the coordinating firms must be able to monitor one-another's market behavior in order to detect whether any firm in the group is deviating from the terms of coordination. Second, there must be credible and timely deterrent mechanisms at hand in order to prevent deviation from the coordinated outcome. Third, the actions of current and future competitors, as well as consumers, must be unlikely to jeopardize the gains expected from the coordination, a factor that will depend on issues such as market entry and countervailing buyer power.¹²³

6.1.3.1 Deficiencies

The Commission holds in para 41 of the merger guidelines:

“A merger may also make coordinating easier for sellers who were coordinating already before the merger, either by making the coordination more robust or by further departing from the competitive outcome. It is unlikely that the Commission would approve a merger if coordination were already taking place prior to the transaction unless it determines that the merger is likely to disrupt such coordination”.

This paragraph seems highly unjustifiable. If the market is already, prior to the merger, conducive to coordinated behavior, and the merger does not increase such coordination, then surely, the merging parties should not be under the obligation to demonstrate that the merger would ‘disrupt coordination’. The high burden of proof imposed on the merging parties is virtually impossible to attain; it must be considered as extremely difficult, if not impossible, to show the disruptive effect of the merger on pre-existing coordination.

The merger guidelines fail to clarify what type of, and the level of evidence required, for the Commission to show with regards to an increased likelihood of coordination. Moreover, the guidelines fail to sufficiently demonstrate the factors that are likely to facilitate the monitoring of the terms of the coordination and the deterrent mechanisms. Important factors that need explaining are: homogenous products, market transparency, symmetry of market shares, stable demand condition, repeated interaction, low buyer power and available excess capacity.

¹²³ Merger guidelines Para 44.

Lastly, the Commission needs to elaborate on punishment mechanisms. The merger guidelines on para 61 holds:

“[...] punishment mechanisms [...] should not be understood in the strict sense that such a mechanism necessarily punishes individually a firm that has deviated.”

It is generally recognized that the effective way of discouraging price-competition is through targeted retaliation, e.g. retaliation mechanisms are activated on an individual basis against deviating firms¹²⁴.

6.1.4 Countervailing Factors¹²⁵

6.1.4.1 Buyer Power¹²⁶

The merger guidelines hold that the competitive pressure on a firm is not only exercised by the competitors, but can also come from its competitors; where appropriate, the Commission will take into consideration plausible impacts that consumers may have to counterbalance the increase in market power due to a proposed merger.¹²⁷ It is even held that firms with very high market shares may not be able act independently because of the buyer power of their customers. The Commission may conclude that buyer power can sufficiently counterbalance a proposed anticompetitive merger; however, it is pointed out that it is not enough that buyer power exists prior to the merger it must also remain effective following the merger¹²⁸.

The definition of customers' buyer power is taken from the Commission's own decision in *Danish Crown/Vestjyske Slagterier*¹²⁹, where it is held that buyer power should be understood as the ability of large customers *“[...] within a reasonable timeframe to resort to credible alternatives if the supplier decides to increase prices or to deteriorate the conditions of delivery”*.¹³⁰ The merger guidelines give examples of such situations, one of which mentions how a large customer, immediately after an increase in price from its supplier, could switch to other suppliers, enabling workable competition in highly concentrated markets.

6.1.4.2 Deficiencies

The merger guidelines merely point out that buyer power *“[...] is sufficient to prevent the creation or strengthening of a dominant position as a result of which effective competition would be significantly impeded [...]”*¹³¹. However, it fails to acknowledge that in order for buyer power to be

¹²⁴ See Lindsey Alistair, *The EC Merger Regulation: Substantive Issues*, 2003, p. 354.

¹²⁵ See merger guidelines section IV, V and VI including *Buyer Power, Entry and Efficiencies*.

¹²⁶ See merger guidelines section IV, Para 75-77.

¹²⁷ *Ibid.* Para 75.

¹²⁸ *Ibid.* Para 77.

¹²⁹ Case IV/M.1313, *Danish Crown/Vestjyske Slagterier*, [2000] OJ 20/1, paras.171-173

¹³⁰ Merger guidelines Para 76.

¹³¹ *Ibid.* Para 77.

effective, customers must have alternative sources of supply or being capable of threatening to set up alternative supply arrangements. The section on countervailing buyer power is too scarce. It needs to be expanded to include specific examples explaining where buyer power can be effective.

6.1.5 Entry¹³²

This section clarifies the circumstances, in which potential entry will be considered as a factor effectively constraining the behavior of the merging firms on the market. It is held that in order for entry to be considered a sufficiently competitive constraint, it must be shown to be “[...] *likely, timely and efficient in its magnitude and scope to prevent the potential anti-competitive effects of the merger*”¹³³. If the Commission finds strong evidence that these conditions are at hand, it is unlikely to prohibit a proposed merger.

The Commission will concentrate on specific features of the relevant market with regards to possible entry barriers. The merger guidelines hold that if entry barriers are low, merging firms are more likely to be constrained by new entrants; conversely, when entry barriers are high, merging firms are expected to gain market power and thus have the ability to raise prices since there are no new firms that will be entering the market.¹³⁴ Moreover, the Commission will examine entry barriers in the context of the history of the industry, e.g. it is not likely that the Commission will find barriers to entry in markets that have experienced frequent and successful examples of entry. Conversely, if entry has been particularly difficult in the past, entry would appear to remain difficult in the future.¹³⁵

The merger guidelines give the following examples of entry barriers¹³⁶:

- Regulatory barriers: active firms have an advantage over new entrants, for example by holding one of a restricted number of licenses.
- Active players may enjoy technical advantages such as access to essential facilities, R&D and intellectual property rights, which make it difficult for new entrants to compete on equal footing.
- Certain markets are difficult to enter because of the need of a certain reputation or experience, which is necessary in order to compete successfully. Important factors to take into account are consumer loyalty, closeness of relationship between suppliers and customers and strong brands.

¹³² *Ibid.* Para 78-86.

¹³³ *Ibid.* Para 79.

¹³⁴ *Ibid.* Para 80.

¹³⁵ *Ibid.* Para 85.

¹³⁶ *Ibid.* Para 81.

The guidelines further hold that one must take into consideration the “*likely evolution of the market*” in assessing whether new entry will be profitable. It is held that entry is more likely to be profitable in markets with high growth expectation than in markets where growth is expected to decline. Scale economies or network effects make entry unprofitable unless the new entrant can obtain a large market share.¹³⁷

6.1.5.1 Deficiencies

The merger guidelines fail to mention in particular three fundamental issues regarding entry barriers:

1. Concerning cost of entry, the guidelines should acknowledge that fixed costs associated with entering a market cannot be considered an entry barrier unless they are sunk costs¹³⁸. Moreover, some sunk costs are determined by the firms themselves, e.g. the amount a firm is prepared to spend on advertisement. This means that sunk costs do not necessarily have to be the same for all prospective entrants.
2. Interestingly, the merger guidelines fail to mention the likelihood of profitability for new entrants in pre-merger situations¹³⁹. New entrants must know if entry will be profitable at pre-merger prices. Profitability will only be at hand if the new entrant reasonably can expect that it will enter the market at or above its break-even sales at pre-merger prices. The US Horizontal Guidelines para 3.3 consider the likelihood of entry on this basis, e.g. entry is unlikely if break-even level is large in relation to the size of the market. Conversely, if break-even sales are small (e.g. most sales are above break-even sales), this might suggest that entry is easy.
3. As mentioned above, the merger guidelines hold that in order for entry to sufficiently offset competition concerns, it must be [*likely,*] *timely* [and *efficient*]¹⁴⁰. The guidelines do not give specific guidance on the timeframe, on which the Commission will assess entry to be considered timely. The merger guidelines should be able to provide guidance on what generally constitutes timely entry. The US Merger Guidelines¹⁴¹, the Irish Guidelines¹⁴² and the UK’s OFT

¹³⁷ *Ibid.* Para 83.

¹³⁸ Sunk costs include expenditures that are not recoverable.

¹³⁹ This is recognized in both the US Horizontal Guidelines, para 3.3 and in the Irish Merger Guidelines para 5.4 (Notice in respect of Guidelines for Merger Analysis, Decision No N/02/004[2002]).

¹⁴⁰ See also merger guidelines Para 79.

¹⁴¹ US Merger Guidelines Para 3.2.

¹⁴² Irish Guidelines Para 5.3.

Draft Merger Guidelines¹⁴³ all hold that entry is considered likely, if it occurs within two years of the merger.

6.1.6 Efficiencies¹⁴⁴

The merger guidelines confirm that the Commission will consider efficiencies in its assessment of mergers; in fact, the Commission will consider any substantiated efficiency claims made by the merging parties. This is an important acknowledgement and comes as a response particularly to the *Airtours* judgment.

The Commission will consider efficiencies that (1) directly benefit consumers in the relevant market, (2) are merger specific, (3) are substantial and (4) are verifiable¹⁴⁵. The merging parties must prove why these efficiencies will offset any adverse effect on competition that the merger might have. The Commission holds that efficiency arguments are unlikely to be successful if the merger will result in a monopoly (or close to a monopolistic situation). Interestingly, in one aspect, the section on efficiencies in the merger guidelines may be more favorable than that of its American counterpart: the parties to a merger do not have to show that the efficiencies attained as a result of a merger could have been achieved through other means. However, the consumer welfare standard adopted in the merger guidelines, merely confirms that efficiencies may be taken into account where they increase rivalry in the market so that no dominant position as a result of which effective competition would be significantly impeded is created or strengthened.

The Commission is more likely to consider efficiencies where cost efficiencies lead to reductions in variable or marginal costs rather than fixed costs, since the former is more likely to result in lower consumer prices. The same holds true for efficiencies that lead to new or improved products or services.¹⁴⁶

Efficiencies will be considered *merger specific* when they are a direct consequence of the merger. The Commission will concentrate on realistic and attainable alternatives rather than theoretical cases.¹⁴⁷ The Commission must also be in a position to assess whether the efficiencies are *substantial*¹⁴⁸ enough to counterbalance a merger's potential harm to consumers. It is up to the parties to quantify the efficiencies where reasonably possible. Efficiencies will be *verifiable*¹⁴⁹ if the Commission can be reasonably certain that the efficiencies are likely to take place. In this respect, the merger guidelines make clear that the longer efficiencies are

¹⁴³ UK's OFT Draft Guidelines Para 4.34 (Office of Fair Trading, The Competition Act of 1998: Market Definition § 2.8 [1999])

¹⁴⁴ Merger guidelines Para 87-95.

¹⁴⁵ *Ibid.* para 90.

¹⁴⁶ *Ibid.* para 91-92.

¹⁴⁷ *Ibid.* para 93.

¹⁴⁸ *Ibid.* para 94.

¹⁴⁹ *Ibid.*

projected into the future, the less weight will be assigned in the Commission assessment.

6.1.6.1 Deficiencies

As mentioned above, efficiencies may be taken into account under certain conditions. The merger guidelines fail to explicitly recognize that efficiencies can outweigh the adverse effects of the creation or strengthening of a dominant position as a result of which effective competition would be significantly impeded, when the efficiencies will be passed on to consumers. This should be appropriately acknowledged in the guidelines.

Moreover, the merger guidelines are unclear as regards the burden of proof. It is unclear whether arguments concerning efficiency are part of the substantive test or form part as a subsequent defense. Para 95 holds: “[...] *the relevant information, which could allow the Commission to assess whether the merger will bring about the sort of efficiencies allowing to clear a merger, is uniquely in the possession of the merging parties. It is, therefore, incumbent upon the notifying parties to provide in due time all relevant information necessary to demonstrate that the efficiencies are merger specific, substantial, timely and verifiable [...]*”. It is not stated that the notifying parties must show that the criteria for a successful efficiency argument has been fulfilled. If efficiency arguments form part of the substantive test (which should be the case) then the burden of proof should not rest solely on the notifying parties.

Lastly, the guidelines lack explicit examples concerning the types of efficiency arguments likely to be successful and the ones irrelevant to a competitive analysis. Such examples would serve as good guidelines for the notifying parties.

7 COLLECTIVE DOMINANCE

The sections above have aimed to providing an understanding of past and present EC merger control in the context of collective dominance in oligopolistic markets. The following intends to serve as an analysis of the concept of collective dominance as it stands today and how it may stand tomorrow.

7.1 Test for Assessing Collective Dominance

The *Airtours* judgment¹⁵⁰ (later confirmed in the merger guidelines¹⁵¹), established that there are three basic conditions that must be fulfilled for collective dominance to be sustainable. First, there must be a sufficient degree of market transparency. Second, there must be credible retaliatory mechanisms so as to convince the coordinating firms not to deviate from the common policy. Third, the actions of outsiders, e.g. current and future competitors and customers, should not be able to jeopardize the results expected from the coordination (competitive fringe).

7.1.1 Modified Tripartite Test

In order to fully assess collective dominance, the tripartite test can be further developed into the following *modified tripartite test*¹⁵² in order to comprise all necessary elements:

First, one must establish if coordination can be reached without the need for an express agreement¹⁵³. This requires both that:

1. The firms involved will (tacitly) coordinate a specific activity, e.g. price, output or market shares; and
2. There is sufficient transparency enabling all firms to identify the specific activity without the need for an express agreement.

Second, firms must have the ability to raise prices through tacit coordination, without being defeated by buyer-power from consumers or by competitors who are active in the market, but not active in the coordination scheme.

Third, firms must have the incentive to tacitly coordinate their activities. Hence, the coordinated outcome must be stable over time so that suppliers do not deviate from the common policy. Such stability arises if (1) firms gain from the coordination and (2) are deterred from deviating from the scheme. The existence of a credible retaliatory mechanism is crucial as to

¹⁵⁰ *Airtours v Commission* Para 62.

¹⁵¹ Merger guidelines Para 44.

¹⁵² Alistair, p. 311.

¹⁵³ Or a concerted practice (see Article 81 of the EC Treaty).

whether coordination will be sustainable over time. If there are no such mechanisms, firms will most likely deviate from the coordination scheme by charging lower prices, thus destroying the expected coordinated outcome (see game theory – prisoner’s dilemma above section 2.4).

In determining whether the three criteria in the *modified* tripartite test above have been met, a wide range of market characteristics may be important in order to establish the likelihood of the creation of a collective dominant position. These characteristics early became known as the ‘checklist’¹⁵⁴. Unlike the tripartite test, not all elements of the checklist are determinative whether tacit coordination is likely to result from the merger. Rather, what needs to be taken into account, is whether the elements taken together amount to a situation whereby the three necessary conditions in the tripartite test are satisfied.

7.2 Coordination Concerning a Specific Activity

If firms are not able to identify a specific activity (e.g. price, output or market share) around which they will tacitly coordinate their business decisions, a situation of collective dominance will never arise (first arm of the first criteria of the modified tripartite test).

7.2.1 Product Homogeneity¹⁵⁵

It is important to assess the degree to which a product is homogenous. A product market with a high degree of homogeneity makes it easier to distinguish if firms tacitly coordinate their activities.

If coordination concerns ‘simple’ activities, such as the price of homogenous products, tacit coordination is more likely (and is also much easier to prove). However, if coordination concerns complex activities, such as to tacitly coordinate restrictions for investments in new technology¹⁵⁶, coordination will most likely not arise without an express agreement.

7.3 Transparency

Tacit coordination will only arise if there is sufficient transparency in the market enabling all participants to identify the specific activity (price, output, market share etc.), around which the common policy will take place¹⁵⁷. Highly transparent markets allow firms to mutually monitor their competitors and thus tacitly coordinate on this basis. In *Airtours*, the CFI held that “[...] *the fact that a market is sufficiently transparent to enable*

¹⁵⁴ The ‘earliest’ checklist was developed in the Nestlé/Perrier case.

¹⁵⁵ Product homogeneity is defined as the degree of proximity between two products. Examples of homogenous products: bottled still water (*Nestlé/Perrier*) and platinum (*Gencor/Lonhro*).

¹⁵⁶ Example: restricting investments for alternative fuel in the car sector.

¹⁵⁷ *Airtours v Commission* Para 159.

*each member of the oligopoly to be aware of the conduct of the others is conducive to the creation of a collective dominant position*¹⁵⁸.

Transparency is closely linked to the specific activity, which can be coordinated; in order for tacit coordination to occur, markets must be sufficiently transparent so that one is able to detect coordination of price, market share, and/or customer allocation. For example, if prices are transparent, cheating is easier to detect, hence serving as an indication that tacit coordination can be sustainable over time (under the condition that there are credible retaliatory mechanisms).

Most obviously, transparency is at hand where firms give prompt notice of price changes. It can also arise through public announcements¹⁵⁹, publications of price lists and statistical information¹⁶⁰. Structural links (see section 7.4.9 below) may also increase transparency, since firms become aware of their competitors' strategies, cost structures and plans.

7.3.1 Transparency for Monitoring

Transparency also allows firms to monitor their competitors' behavior in order to verify that they are not cheating from the common policy. In the Airtours case the CFI held:

*“[...] each member of the dominant oligopoly must have the ability to know how the other members are behaving in order to monitor whether or not they are adopting the common policy [...] it is not enough for each member of the dominant oligopoly to be aware that interdependent market conduct is profitable for all of them but each member must also have a means of knowing whether the other operators are adopting the same strategy and whether they are maintaining it. There must, therefore, be sufficient market transparency for all members of the dominant oligopoly to be aware, sufficiently, precisely, and quickly, of the way in which the other members' market conduct is evolving.”*¹⁶¹

7.4 Ability to Tacitly Coordinate

In order to evaluate firms' ability to tacitly coordinate their activities, a whole range of different evidence must be shown. As stated above, the required 'quantity' and 'quality' of evidence for a position of collective dominance to be present, is yet to be shown. In the Airtours case, the CFI held:

“[...]to prove the existence of a collective dominant position to the requisite legal standard, the Commission must [...]

¹⁵⁸ *Ibid.* Para 156.

¹⁵⁹ Merger guidelines. Para 59.

¹⁶⁰ IV/M.1383, *Exxon / Mobil* Para 474.

¹⁶¹ *Ibid.* Para 62.

*establish that the foreseeable reaction of current and future competitors, as well as of consumers, would not jeopardize the results expected of the common policy.*¹⁶²

*[...] to prove conclusively the existence of a collective dominant position in this instance, the Commission should [...] have established that the foreseeable reactions of current and future competitors and consumers would not jeopardize the results expected from the large operators' common policy. In this case, that implies that where the large tour operators, for anti-competitive purposes, reduce availability to a level below what is required to adjust to anticipated trend in demand, such a reaction must not be offset by their current competitors, smaller operators, any potential competitors, tour operators with a presence in other countries or in long-haul market, or their customers [UK consumers] reacting in such a way as to render the dominant oligopoly unviable.*¹⁶³

The following intends to display a number of circumstances that has been and should be taken into account in the Commission's (and the Courts') assessment of firms' ability to tacitly coordinate their activities.

7.4.1 Market Concentration

If a market consists of a large number of firms, tacit coordination is unlikely to arise because of: (i) an increased possibility for disagreement on the tacitly coordinated outcome, (ii) greater scope of cheating¹⁶⁴ and (iii) a decreased transparency making monitoring more difficult.

As mentioned above in Section 6.2, concentration can be measured using the HHI, which the Commission now has acknowledged in its merger guidelines. Tacit coordination may arise between some but not all the firms in a market. Assume that three suppliers each hold 30 percent of the market. In addition, there are 10 suppliers each holding a market share of 1 percent. Here, tacit coordination is likely to take place between the three main suppliers and not the remaining ten. The general rule concerning the number of firms, which together could amount to a situation of collective dominance was laid down in *Price Waterhouse/Coopers Lybrand*, where the Commission held: “[...] *collective dominance involving more than three or four suppliers is unlikely simply because of the complexity of the interrelationships involved, and the consequent temptation to deviate; such a situation is unstable and untenable in the long term*”¹⁶⁵.

¹⁶² *Airtours v Commission* Para 192.

¹⁶³ *Ibid.* Para 210.

¹⁶⁴ Europe Economics - “*Study on Assessment Criteria for Distinguishing between Competitive and Dominant Oligopolies in Merger Control*”, May, 2001, p 21.

¹⁶⁵ *Ibid.* Para 466.

7.4.2 *Competitive Fringe*

As mentioned, tacit coordination is unlikely to arise if forces outside the oligopoly, e.g. the competitive fringe (competitive firms and/or consumers), can counterbalance the market power of the alleged dominant group. Subsequent to the identification these forces, it is necessary to determine whether, and to which extent, they can undermine the common policy.

In the Airtours case, the CFI held that the question is not for the smaller tour operators to reach the size of the market leaders; rather the question is whether the hundreds of small tour operators, taken as a whole, can “[...] *respond effectively to a reduction in capacity put on to the market by increasing their capacity to take advantage of the opportunities inherent in a situation of overall under-supply and whether they can thereby counteract the creation of a collectively dominant position*”¹⁶⁶

Conversely, the theory of competitive fringe may have an important impact if a large firm acquires an important fringe player. Even though the merger does not have an impact on the allocation of market share, it may still have an impact on competition due to the elimination of an important fringe player.

7.4.3 *New Entry*

Oligopolies would not be able to implement a tacitly coordinated scheme if it would be defeated by new entry, which is *timely, likely and sufficient* so as to prevent the creation or strengthening of a collectively held dominant position¹⁶⁷. In the Airtours case, the CFI held that it is not important if potential new competitors are able to compete on ‘*equal footing*’ with the large tour operators. Rather, the question is whether there is scope for potential “[...] *competitors to take advantage of opportunities afforded by the large operators restricting capacity put onto the relevant market to below a competitive level*”¹⁶⁸.

High barriers to entry were found in Nestlé/Perrier, where the Commission found the market to be stagnant. In addition, high entry barriers were at hand due to the well established brand names of Nestlé and Perrier and the firms’ exceedingly high advertising costs. In Gencor/Lonhro, the Commission held that new entrants on the platinum market were unlikely since it entailed extremely capital intensive investments associated with high sunk costs.

7.4.4 *Market Development*

If a market grows rapidly, it is less likely that tacit coordination will arise. Such markets tend to give firms the incentive to compete more intensely rather than to coordinate their activities, since potential profits out-weigh

¹⁶⁶ *Airtours v Commission* Para 213.

¹⁶⁷ Merger guidelines Section V.

¹⁶⁸ *Airtours v Commission* Para 266.

gains from coordination. Moreover, rapidly growing markets generally attracts new players making it difficult to detect cheating. Conversely, slow-growing markets are more likely to be subject to tacit coordination; such market conditions generally give little incentive to compete, cheating is easy to detect and entry barriers are high.

In relation to market growth, the CFI in *Airtours* held: “[...] *economic theory regards volatility of demand as something which renders the creation of a collective dominant position more difficult. Conversely, stable demand, thus displaying low volatility, is a relevant factor indicative of the existence of a collective dominant position, in so far as it makes deviation from the common policy more easily detectable, by enabling to be distinguished from capacity adjustments intended to respond to expansion or contraction in a volatile market*”¹⁶⁹.

7.4.5 *Symmetrical Costs Structures*

If parties have similar costs structures¹⁷⁰, this can serve as an indication that the market is conducive to tacit coordination. These conditions increase the risk of retaliation; as a consequence, sustainable tacit coordination is more likely to follow since each company is aware of the conditions at hand. Moreover, similar costs structures increase the level of transparency; a supplier faced with a decrease in profitability must determine whether this happened because of a rival’s deviation from the common policy or by his own mistake.¹⁷¹

By contrast, differences in costs structures give different incentives in the way suppliers set their prices and output. Low cost suppliers generally prefer a lower price and a higher output strategy than that of their counter-suppliers. Differences in costs structures usually result in aggressive competitive behavior¹⁷². Subsequently, a merger, which increases costs asymmetry, is likely to reduce the risk of tacit coordination.

7.4.6 *Symmetrical Market structures*

Similarities in market structures (e.g. market shares) used to be a substantial factor in the Commission’s assessments on the likelihood of a tacitly coordinated outcome. Recently, the Commission has put less emphasis on the importance of symmetry in market structures. The market shares of members of an oligopoly do not necessarily have to be symmetrical in order for oligopolistic dominance to take place and a subsequent tacitly coordinated outcome. In many cases, especially after a merger, there will be a ‘leader’ of the oligopoly. The relevant issue in the assessment of

¹⁶⁹ *Airtours v Commission* Para 139.

¹⁷⁰ Parties with similar costs structures have similar pricing and output incentives.

¹⁷¹ Europe Economics, p. 31.

¹⁷² Alistair, p. 334.

symmetry in market shares is whether the market shares indicate a sufficient degree of similarity in incentives and retaliation possibilities.¹⁷³

7.4.7 Capacity

Suppliers' capacity can be relevant in relation to the analysis of tacit coordination due to the following¹⁷⁴:

Symmetry in over-capacity may affect the likelihood of tacit coordination: If the members of an oligopoly try to achieve full or near to full capacity, there is an increased risk of cooperation; the firms have a lower incentive and ability to deviate from the scheme, since they cannot raise their outputs. Conversely, if one supplier has a substantial over-capacity and others do not, the likelihood of tacit coordination is reduced, since the supplier with over-capacity has an incentive to reduce prices to win business while the others do not.¹⁷⁵ If most suppliers have over-capacity, it is likely to increase the risk for tacit coordination; the incentive here is not to compete since any reduction in price can be quickly matched by the competitors, amounting to an effective retaliatory mechanism.

The availability of over capacity is likely to provide an effective punishment mechanism: The most effective punishment mechanism against a deviating firm is an increase in output and a reduction in market price by the members of an oligopoly. This requires that the members always have over-capacity in the event they need to engage in retaliatory measures. If the majority of the oligopolistic members do not possess over-capacity, incentives are given to deviate from the scheme since there are no effective retaliatory mechanisms.

7.4.8 Countervailing Buyer Power

As mentioned above, the existence of buyers with substantial buyer-power decrease the risk of tacitly coordinated schemes. Consumers' countervailing buyer power may either prevent oligopolists from engaging in coordinated schemes or provide an incentive to deviate from the scheme. This can be done in two ways. First, consumers can play suppliers against each other, threatening to switch to the other supplier if his demand is not met. Second, firms may be deterred from engaging in coordinated activities by (1) the threat of new entrants sponsored by consumers¹⁷⁶ or (2) in-house production, i.e. customers start to produce the goods themselves¹⁷⁷.

¹⁷³ Commission paper presented at OECD, p. 213.

¹⁷⁴ Alistair, p. 437.

¹⁷⁵ Interestingly, this reasoning suggests that the HHI is misleading in the examination of tacit coordination.

¹⁷⁶ IV/M.1225. *Enso/Stora* [1999] OJ L254/9, Para 91.

¹⁷⁷ IV/M.337. *Knorr-Bremse/Allied Signal* [1993] OJ C 257.

7.4.9 Structural Links

The CFI, in *Gencor*, held that structural links¹⁷⁸ are not necessary for a finding of collective dominance but that they may increase the likelihood of tacit coordination¹⁷⁹. The Commission later acknowledged this: “[Structural links] *may reduce the competitive zeal between the oligopolists, they represent potential means of retaliation and depending on the circumstances such links would also result in a certain common commercial interest in the market in question. Therefore, the impact of a merger in terms of whether it creates or gives a different quality to such structural links needs to be assessed. However, structural links are not a necessary condition for a finding of oligopolistic dominance*”¹⁸⁰.

Structural links between firms can be relevant provided that a mechanism can be identified, through which the links may affect the oligopolists’ ability to tacitly coordinate their activities. In *Airtours*, the CFI held that the Commission had not proved why *commercial links* (e.g. purchase of airline seats from other tour operators and sale of its own products in agencies owned by other tour operators) would amount to strong economic links between the large tour operators. Contrary to the Commission’s findings, the CFI concluded that these links were present simply due to efficiency: it was in the tour operators’ interest to be profitable, e.g. to maximize their revenues and to minimize expenditures¹⁸¹ resulting in lower prices for consumers.

7.5 Incentives to Tacitly Coordinate

As held above, the third condition in the modified tripartite test comprises that the coordinated outcome must be stable over time so that suppliers do not deviate from the common policy. Such stability arises if (1) firms gain from the coordination and (2) are deterred from deviating from the scheme.

7.5.1 Coordination Increases Firms’ Profits

The main idea behind coordinated schemes is to enhance profits for the firms involved. For example, tacit coordination concerning price will increase profits under the condition that (1) the firms raise their prices and (2) customers are loyal to the product despite the increase in price. The question of whether a price increase will be profitable depends, in particular, on the elasticity of demand at the prevailing price and suppliers’ cost functions.

In relation to (1) and (2), it is interesting to analyze the critical loss, e.g. where an increase in price would be followed by a decline in sales, making

¹⁷⁸ These links may comprise: partial cross-shareholdings, family-links with economic consequences, cross-director-ships, commercial links, joint venture, alliances, shared ownership of distribution channels of supplies, cross-licenses, etc. See Alistair, p.344.

¹⁷⁹ *Gencor/Lonhro* Para 276.

¹⁸⁰ Commission paper presented at OECD, *supra* note 151, p. 213.

¹⁸¹ *Airtours v Commission* Para 285.

the price increase unprofitable.¹⁸² It follows that where marginal costs are low¹⁸³, even relatively small price increases, say 5 percent, may turn out to be unprofitable where, as a result of the price increase, sales are declined by 5,5 percent. Conversely, where marginal costs are high¹⁸⁴, a price increase of 5 percent may turn out to be unprofitable only where sales decline by 10 percent.

7.5.2 Retaliatory Measures

If firms engage in tacit coordination, then one or more firms will, most likely, find it tempting to deviate from the scheme; if tacit coordination concerns price, it will be profitable for a firm to set its prices below the tacitly coordinated level in order to win business from the other firms, hence increasing his sales. Clearly, if deviation from coordinated schemes were to be unpunished, there would be no incentive to stick with the scheme, e.g. the tacitly coordinated outcome would not be sustainable over time.

The first time the CFI acknowledged the importance of retaliatory measures was in *Gencor*. It held that retaliatory measure in oligopolistic markets is a strong factor in assessing whether there will be an enhanced coordinated outcome:

“Price transparency is a fundamental factor in determining the level of market transparency where there is an oligopoly. By means of the price mechanism, the members of an oligopoly can, in particular, immediately discern the decision of other members of the oligopoly to alter the status quo by increasing their market share and they make such retaliatory measures as may be necessary in order to frustrate actions of that kind”¹⁸⁵.

In *Airtours*, the CFI identified retaliatory measure as a necessary condition for a finding of collective dominance. While doing so, it concluded that the Commission must not necessarily show that there is a certain degree of severity attached to the retaliatory measure:

“[...] the situation of collective dominance must be sustainable over time, that is to say, there must be an incentive not to depart from the common policy[...] It is only when all members of the dominant oligopoly maintain the parallel conduct that all can benefit. The notion of retaliation in respect of conduct deviating from the common policy is thus inherent in this condition. [...]

It is thus important to ascertain whether the individual interests of each major tour operator [...] outweigh the common interests of the members of the alleged dominant oligopoly [...] That would be the case if the absence of

¹⁸² Alistair, p. 350.

¹⁸³ For example: adding a subscriber in a network has virtually zero costs.

¹⁸⁴ For example: the luxury clothing product market.

¹⁸⁵ *Gencor v Commission* Para 227.

deterrents induced an operator to depart from the common policy, taking advantage of absence of competition to that policy, so as to take competitive initiatives and derive benefit from the advantages inherent therein [...].

[...] the Commission must not necessarily prove that there is a specific 'retaliation mechanism' involving a degree of severity, but it must none the less establish that deterrents exist, which are such that it is not worth the wile of any member of the oligopoly to depart from the common course of conduct to the detriment of the other oligopolists.¹⁸⁶

Although the Commission must not establish that punishment mechanism exists without having to point out every aspect of that mechanism, it is clear that if the retaliatory measures are not sufficiently strong, parties will start to deviate from the common policy. The merger guidelines¹⁸⁷ hold that coordination cannot take place without sufficiently strong retaliatory measures, so as to convince all participating firms that it is in their best interest to obey by the terms of coordination.

The way, in which firms will have the incentive to comply with a tacitly coordinated scheme, is threefold¹⁸⁸:

1. High degree of transparency making detection of cheating high. In addition, the delay between cheating and retaliation must be short in time.
2. Retaliation must be sufficiently strong; the other firms must take such retaliatory measures so that the deviating firm is worse off following his decision to cheat.
3. The threat of retaliation must be credible, e.g. a prospective deviating firm will effectively conclude that the other firms will choose to invoke retaliatory measures.

The efficacy of retaliatory mechanisms depends on the probability of cheating being detected and the speed with which detection and punishment takes place¹⁸⁹. The faster these two elements are, the greater the incentive not deviate from the tacitly coordinated scheme is. By contrast, if detection and punishment are slow, firms are given the incentive to cheat¹⁹⁰. Economists have used the concept of game theory in order to explain when retaliatory mechanisms are sufficiently strong so that tacitly coordinated schemes are stable over time: a tacitly coordinated outcome will only arise if the chances of detection multiplied by the punishment exceed the gains from cheating¹⁹¹.

In order for retaliatory mechanisms to be effective, they need to be sufficiently powerful. The merger guidelines hold: "A firm would only

¹⁸⁶ *Airtours v Commission* Para 62 and 193-195.

¹⁸⁷ Merger guidelines Para 63.

¹⁸⁸ Martin S., *Advanced Industrial Economics*, 2nd edition, 2002, p.295.

¹⁸⁹ Alistair, p. 353.

¹⁹⁰ Merger guidelines. Para.63.

¹⁹¹ Alistair, p. 354.

*choose to deviate from the coordinated practice if the discounted awards from deviating are larger than the discounted cost of the punishment [...]”*¹⁹². By way of comparison, the US Merger Guidelines hold: “*Credible punishment [...] may not need to be more complex than temporary abandonment of the terms of coordination by the other firms in the market [...]”*¹⁹³. There are, of course, more sophisticated ways of dealing with retaliation. In *Airtours/First Choice*¹⁹⁴, the Commission found that retaliation was based on structural links between the parties in distribution and charter airline seats¹⁹⁵. Effectively, the durability of the retaliation mechanism must be sufficiently powerful to counterbalance the degree of probability and the incentives firms have to deviate from tacitly coordinated schemes.

Lastly, in order for firms to remain with a tacitly coordinated scheme, the retaliatory threat needs to be credible, e.g. firms must be aware that retaliatory measures will be invoked when/if deviation occurs. Evidently, if retaliatory threats are not followed through, incentives are given that deviation is accepted, and subsequently the credibility is undermined to such extent that it no longer will allow for a tacitly coordinated outcome.

¹⁹² Merger guidelines. Para.62.

¹⁹³ US Horizontal Merger Guidelines, Para 2.12.

¹⁹⁴ *Airtours/First Choice* Para 143 and 153.

¹⁹⁵ However, this assessment was not shared by the CFI: it held that such retaliatory mechanisms would not be able to occur due to the lack of transparency in the market.

8 CONCLUSIONS

The concept of collective dominance was developed by the Commission to prevent anti-competitive oligopolistic markets from coming into existence. The instruments, from which the Commission intended to assess collective dominance, have been significantly modified due to the judgment rendered by the CFI in *Airtours*. It is no longer sufficient for a finding of collective dominance to demonstrate that a merger makes it rational for oligopolists to, individually, decrease their output or increase their prices. Evidently, such definition would merely serve as a restatement of oligopolists' awareness of their own interdependence. The named awareness exists in almost all oligopolistic markets. To uphold such a broad definition of collective dominance would ultimately result in the prohibition of all proposed mergers in oligopolistic markets. The CFI, in its *Airtours* judgment, emphasized that it needs to be shown that the markets are such that the adoption of a common policy is both possible and sustainable over time.

It is apparent from the CFI's decision that the dividing line between the normal functioning of oligopolistic markets and collective dominance is very delicate and extremely hard to define. The *Airtours* judgment was a real blow for the Commission and endangered the concept of collective dominance as such. The Commission acknowledged this and tried to tackle the problem by issuing the merger guidelines. The intention of these guidelines was twofold: (1) to provide a framework, on which the Commission will base its assessment on collective dominance, and (2) to provide legal certainty for undertakings operating in oligopolistic markets when considering a merger or an acquisition.

The guidelines are a good step towards clarity. Apart from the HHI index, the Commission accepted the analytical framework applied by the CFI in *Airtours*, e.g. an adoption of the tripartite test: (1) each member of the oligopoly must know how the other members are behaving in order to be able to adopt a common policy, (2) there must be credible deterrent mechanisms, which are sustainable over time so that the members are discouraged from deviating from the common policy and (3) the common policy cannot be jeopardized by competitors and customers. Included in the guidelines is a much awaited efficiency approach, similar to that of its American counterpart.

The judgment delivered by the CFI in *Airtours* and the merger guidelines issued by the Commission have been of tremendous significance in the alignment of future EC Merger Control. Most importantly, there is now an explicit tripartite test for the assessment of collective dominance, with elements of efficiency as an important pillar. The magnitude of transparency of the market, the need for retaliatory measures and the potential influence of competitors and consumers has, at *prima facie*, created legal certainty and adequate guidance.

The most important obstacle is, however, yet to be overcome, namely that of how to assess evidence. The deepened burden of proof, including an

exceedingly complex prospective economic analysis resembles that of an insecure economic prediction. The facts, which would substantiate such predictions, can, as the current case law stands, probably never amount to convincing evidence, regardless of improved working methods by the Commission, such as the appointment of a Chief Economist and systematic peer panel reviews. Such predictions can be easily overturned by the CFI, resulting in ‘collective dominance - no longer a concept in EC Merger Control’! Only in the most obvious cases can collective dominance ‘survive’.

The increased burden of proof, resulting in a virtually impossible task for a finding of collective dominance, has been duly recognized by the Commission. Competition commissioner, Mario Monti, said at the International Bar Association in Brussels November 2002: “*Indeed there are [...] lessons to be drawn from the [three] judgments; in particular; it is clear that the CFI is now holding us to a very high standard of proof and this has clear implications for the way in which we conduct our investigations and draft our decisions*”. In the Commission Press Release that followed the Tetra Laval appeal, the Commission held that the standard of proof imposed by the CFI was disproportionate with regard to the principle of legality under Article 230 of the EC Treaty and impossible to apply in practice. This is an interesting statement. For the first time, the Commission indirectly ‘confessed’ that due to the unfeasibility to obtain an adequate standard of proof, it will no longer be able to prohibit mergers based on (collective) dominance¹⁹⁶.

Airtours, Tetra Laval, Schneider/Legrand and the merger guidelines, all failed to give proper explanation on what amounts to sufficient evidence in order to establish a position of collective dominance. As the case law stands today, it is therefore unlikely that the Commission will try to prohibit a proposed merger on basis of collective dominance¹⁹⁷.

Despite the exceedingly difficult task in providing explicit rules and guidance on the level of standard of proof in merger investigations, the result of the Tetra Laval appeal will be of significant importance. For the first time, this decisive element will be examined by the ECJ. Regardless of the outcome of the appeal, awareness about the problem will lead to further examinations, which hopefully, one day, will lead to legal certainty regarding the quantity and quality of the evidence required for a sustained finding of collective dominance in EC Merger Control.

¹⁹⁶ The Tetra Laval judgment concerned whether the merger would lead to the creation of a dominant position, and not collective dominance. However, both judgments were relevant with regards to the question of evidence, e.g. the Commission’s inability to present convincing evidence, making the Commission statement highly relevant.

¹⁹⁷ Since the CFI rendered its judgment in Airtours in June 2002, the Commission has not attempted to prohibit a merger based on collective dominance.

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