

# MERGER CONTROL

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### EC merger control 2001/2002: from controversy to change

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In the course of 2001 and the first half of 2002, merger control again played a major role in the enforcement of the competition rules by the European Commission ('the Commission'). It was also a period marked by considerable controversy. The Commission issued five prohibition decisions, including *GE/Honeywell*, *Schneider/Legrand*, and *Tetra Laval/Sidel*. *GE/Honeywell* in particular exposed differences in approach between the Commission and the US authorities. The annulment by the European Court of First Instance (CFI) of the Commission's 1999 prohibition decision in *Airtours/First Choice* raised questions about the Commission's approach to collective dominance. At the same time, the Commission's Green Paper on merger review of December 2001<sup>1</sup> has prompted vigorous discussion about the way its merger procedure operates in practice. Many practitioners, companies and even some Member State authorities have advocated major changes to the substantive and procedural rules.

This chapter focuses on the main themes which have characterised these events rather than conducting a case-by-case review. After a brief overview of the relevant statistics, we focus on the main substantive themes: conglomerate mergers, collective dominance, and a possible change of the present dominance test to 'substantial lessening of competition'. It then discusses the jurisdictional and procedural changes proposed by the Commission's Green Paper on merger review, followed by an analysis of the current 'due process' debate. Notably, we offer some comments on the new 'fast-track procedure' before the CFI and the expanded mandate of the Hearing Officer. In conclusion, we suggest that reform beyond what is proposed in the Green Paper is required, but that such reform could first focus on a number of smaller but important procedural issues rather than a sweeping overhaul of the current system.

#### Statistics: many cases, many prohibitions, many appeals

Despite the economic downturn that has affected the world economy, the flow of merger notifications to the Commission in the period considered in this chapter remained substantially unchanged, as

illustrated by the table below.

Significantly, the Commission prohibited five mergers in 2001, more than in any single year since the EC Merger Regulation (ECMR) became effective,<sup>2</sup> and as many mergers as were prohibited in 1998, 1999 and 2000 combined. Importantly, three out of the five prohibition decisions (*GE/Honeywell*, *Schneider/Legrand* and *Tetra Laval/Sidel*) have been appealed, the latter two under the CFI's new 'fast track procedure' (see below) with the aim of ultimately saving the respective deal.

#### Substantive themes: conglomerate effects, collective dominance and the SLC test

Spurred by the Commission's recent prohibition cases and the merger review, the main areas of substantive debate are:

- conglomerate theories such as leveraging through tying or bundling;
- collective dominance; and
- a review of the substantive test under the ECMR.

#### Conglomerate mergers and leveraging theories

The prohibition decisions *GE/Honeywell*<sup>3</sup> and *Tetra Laval/Sidel*<sup>4</sup> both relied in part on the assertion that the combined entity could extend a pre-existing dominant position on one market to a neighbouring product market through 'leveraging' techniques such as mixed bundling (offering two products for a combined price that is lower than if the products were purchased individually) or pure bundling/tying (selling two products only together).

While many economists agree that such leveraging strategies could theoretically be used to induce the exit of rivals, the two decisions have been criticised on the basis that they fail to show to the requisite legal standard that leveraging will in fact be used and will induce permanent exit of rivals. If such exit does not occur, consumers should benefit from the lower prices that are inherent in any leveraging practice. Underlying the disagreement

EC Merger Control – Key figures	1990–2002* <sup>1</sup>	2000	2001	2002** <sup>2</sup>
Notifications	2055	345	335	147
<b>Phase I Clearances</b>				
Compatible with common market	1694	293	299	120
Compatible (with undertakings)	94	28	13	8
<b>Phase II Clearances</b>				
Compatible with common market	22	3	5	2
Compatible (with undertakings)	61	12	10	4
Prohibitions	18	2	5	0

<sup>1</sup> September 21, 1990 to July 31, 2002  
<sup>2</sup> Until July 31, 2002

between the Commission and its critics (including the US antitrust authorities) is a lack of consensus about regulators' ability to predict market outcomes for a period of several years given the many uncertainties as to how the combined entity, competitors and customers will actually behave or react to the behaviour of others. Moreover, there appears to be fundamental disagreement as to how one should weigh the benefits of short-term consumer gains against the risk of competitor exit.

In legal terms, the main question is whether the Commission has not based its prohibition decision on the mere threat of the creation of a dominant position on the neighbouring market, rather than the actual creation of such a position that seems to be required in order to block a transaction under the ECMR. As *Tetra Laval/Sidel* is being reviewed under the new fast-track procedure,<sup>5</sup> the CFI should clarify its view on this issue in October 2002.

#### **Collective dominance and the *Airtours* case**

On June 6, 2002, the CFI gave a landmark judgment<sup>6</sup> annulling the Commission's 1999 decision<sup>7</sup> that had prohibited the merger between UK travel operators *Airtours* and *First Choice*. The CFI held that the Commission had failed to prove that the merger would have resulted in the creation of a collective dominant position, and in particular that the Commission had failed to demonstrate the existence of adequate retaliatory measures that could be directed against a company departing from or 'cheating' on any collusive common policy and that the Commission underestimated the ability of competitors and customers to respond to any anti-competitive collusion by the three industry leaders.

The *Airtours* judgment is significant in that the CFI carried out a very detailed review of the Commission's assessment of the facts. While the Commission has (correctly) stated that the judgment does not fundamentally question its right to challenge mergers on collective dominance grounds, it is clear that the CFI has imposed a high burden of proof on the Commission if it wants to do so. The Commission has now said that it will issue a guidance notice on the substantive assessment of horizontal mergers (including cases of collective dominance) towards the end of this year.

#### **Possible switch to SLC standard**

In the context of its Green Paper, the Commission has launched a debate as to whether the substantive test under the ECMR ('creation or strengthening of a dominant position as a result of which effective competition would be significantly impeded') should be changed to the 'substantial lessening of competition' ('SLC') test that is used in other jurisdictions, most notably the US. The proponents argue that this would serve global convergence, that the SLC test is a 'superior' test in terms of economic assessment and that the change would free up the assessment from an overly narrow focus on dominance (single firm or collective). The counter-argument is that legal certainty will suffer since most EU and EU accession country merger control systems are used to (or have recently introduced) the dominance approach, relying on the last 11 years of EC practice. The Commission has suggested that it may be premature to decide this issue in the context of the present review.

#### **The Green Paper: jurisdictional and procedural issues**

Notwithstanding the interesting discussion of the SLC test, the main focus of the Commission's Green Paper on the Review of the Merger Regulation is on jurisdictional and procedural issues.

#### **Jurisdictional issues**

The cornerstone of the Green Paper's proposed changes is the expansion of the Commission's jurisdiction to all cases in which merger

filings would otherwise be necessary in three or more Member States – a proposal already made during the last review but later abandoned in favour of the alternative turnover thresholds now contained in Article 1(3) ECMR. In a bid to win Member State support, the Commission is proposing at the same time to make it easier to refer more mergers back to the Member States where they affect only national markets. While the extension of the 'one-stop' shopping principle through the broadening the Commission's jurisdiction has a lot of support in the business community, the same is not true for a more generous referral policy since that would undermine the advantages of one-stop shopping.

#### **Procedure**

The Green Paper suggests only one really significant change to the present procedure: the opportunity for the parties voluntarily to 'stop the clock' in order to allow the Commission and the parties more time to discuss remedies, whether at the end of the first phase of review or in the second detailed phase. The added flexibility for the parties has received much support from the business community and is likely to become part of the Commission's formal proposal.

#### **Beyond the Green Paper: due process guarantees**

Although the 'stop the clock' ideas are very welcome, various circles have reacted strongly to the absence of other proposals in the Green Paper in order to address a perceived lack of 'due process guarantees' in the Commission's administrative procedure.<sup>8</sup> The complaints derive from the fact that the same case team within the Merger Task Force acts both as prosecutor and as (at least initial) decision maker. In response to these criticisms, the Green Paper points to two relatively recent innovations that have already been put in place: the new expedited ('fast-track') procedure before the European Courts in Luxembourg, and the expanded mandate of the Hearing Officer. However, it is rather apparent that neither innovation is a decisive change and that further steps towards reform are needed.

#### **Not so fast: the expedited procedure**

To date, court appeals of merger prohibition decisions by the parties to the transaction have been relatively few<sup>9</sup> despite the obvious economic significance for the parties. Out of the 18 prohibition decisions since the entry into force of the ECMR, only nine have been appealed so far.<sup>10</sup> *Airtours*<sup>11</sup> was the first successful appeal, and four others are pending.<sup>12</sup> The reason for the limited enthusiasm for challenging prohibition decisions is the duration of the procedure before the CFI or (if a Member State brings the action) before the European Court of Justice (ECJ). It took the parties nearly three years to obtain the annulment in the *Airtours* case. Very few, if any, proposed transactions can be left in limbo for that long.

To make judicial review more meaningful, the expedited procedure was introduced in February 2001 by amending the procedural rules of the CFI and the ECJ.<sup>13</sup> Under the new procedure, a much earlier judgment is made possible by eliminating the second round of written pleadings, scheduling an early oral hearing, and having the relevant chamber decide the case as a matter of priority.

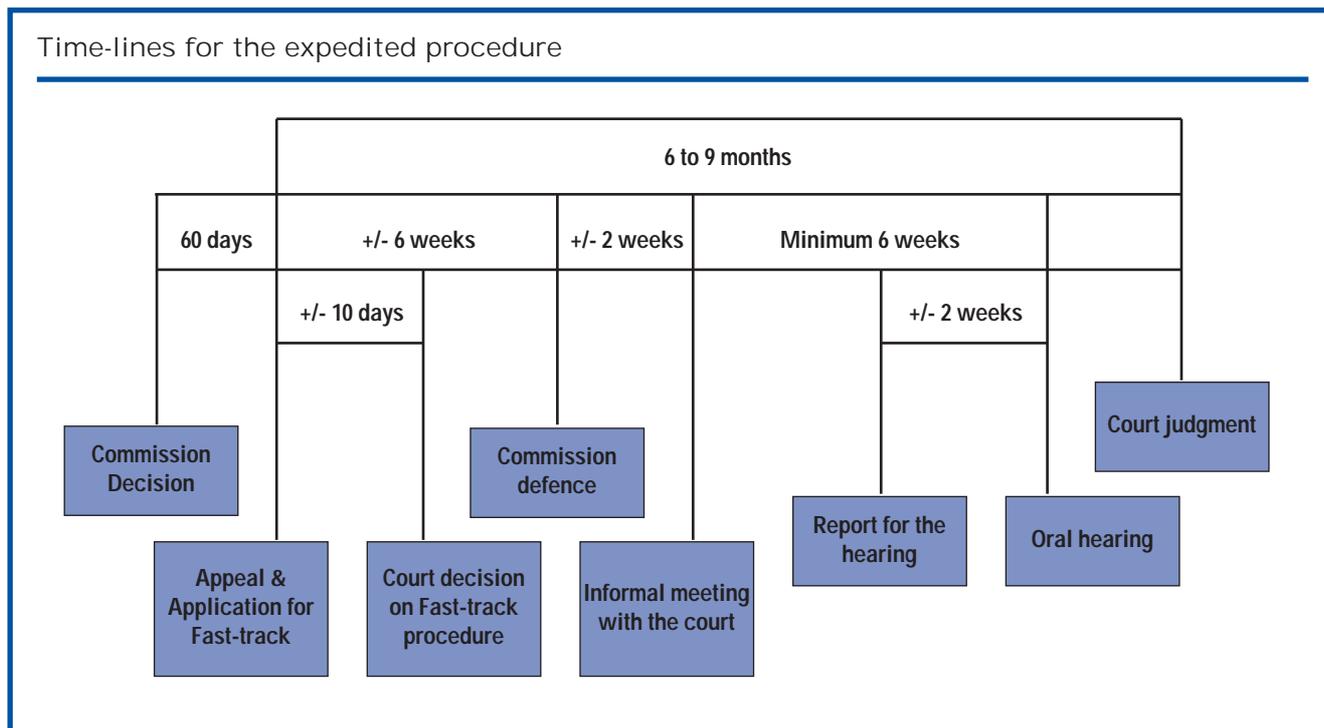
While this procedure is certainly a welcome improvement, and the CFI is doing everything in its power to make the expedited procedure work in practice, it is unlikely that the even the fastest track will be timely enough to keep most merger projects alive. On the basis of the experience in *Tetra Laval/Sidel*, the following time-chart illustrates the duration of the fast-track procedure.

Expediting the procedure further will be difficult given the need for drafting and translation of the relevant documents and the final judgment. As a result, the expedited procedure will only be a significant improvement in terms of effective judicial review in the

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### Time-lines for the expedited procedure



relatively unusual circumstance that the buyer has already purchased the shares of the target, as is the case for both *Tetra Laval/Sidel* and *Schneider/Legrand* – the first two cases in which the expedited procedure is being applied.

#### *The expanded mandate of the Hearing Officer*

In a bid to improve procedural guarantees during the administrative procedure itself, in June 2001 the Commission revised the Terms of Reference of Hearing Officers in competition proceedings.<sup>14</sup> The main changes are:

- The Hearing Officer need no longer be an official of the Commission, and is attached directly to the Commissioner rather than DG Competition.
- There is greater scope for consideration by the Hearing Officer of the procedure leading to the submission of draft decisions to the Competition Commissioner.
- The Hearing Officer's report is now routinely circulated to the Competition Commissioner, the Director responsible, and the competent authorities of the Member States, in addition to the Director-General. The Hearing Officer's report is also attached to the draft decision submitted to the Commissioners, is provided to the addressees of the decision, and is published in the Official Journal with the Commission decision.

These reforms fall short of demands for a fully independent Hearing Officer. Notably, in recent appointments, the Commission has not made use of the possibility of appointing an 'outsider' to either of the two Hearing Officer positions, preferring to fill them with career officials from within DG Competition, which has not assisted perceptions of independence. It is also still an open question whether such officers can have a real impact on the procedure given their still limited role and lack of resources. In particular, many have also been disappointed by the brevity of initial Hearing Officer reports.

#### *The need for further reform*

Most commentators thus agree that there is a need for reform beyond the changes proposed in the Green Paper. Some proposals go as far as moving to a US-style system by requiring the Commission to prove

its case to the CFI before issuing a prohibition. Another frequently heard suggestion is that there should be two separate teams (perhaps even organised in different units within the MTF or DG Competition) for a case which moves from first to second phase, to ensure that the officials making the key decisions on the case approach it with an open mind.

In our view, the time is not yet ripe for such a complete overhaul of the system. Most complaints about a lack of due process guarantees arise from a breakdown of communications between the case team and the parties, in particular during the Phase II procedure. Rightly or wrongly, the perception is that the parties and the Commission often go their separate ways at the beginning of the second phase, preparing their respective views for a major confrontation on a large number of issues in the Statement of Objections ('S/O'), the response to it, and the hearing. To avoid such developments, we think it is important to put mechanisms in place that encourage a progressive narrowing of the issues before the S/O is issued. Some small changes could have a large impact on the overall conduct of the procedure without requiring a change of the ECMR itself. In practical terms we suggest:

- *An extended right of access to the file.* Currently, the Commission's file is only accessible to the parties after they have received the S/O. Thus the parties are often made aware of the full extent of competitor or customer comments or complaints only at this late stage, even though many concerns could have been addressed during the procedure. Following the example of procedural systems employed in other major jurisdictions (eg Italy and Germany), the Commission could consider extending the right of access to the entire procedure.
- *Wider involvement of the parties in the fact-finding.* Similarly, to avoid later complaints of bias or error in the Commission's investigation, the Commission could consider ways of increasing the parties' involvement in the fact-finding process. Following the practice of the German Federal Cartel Office, the Commission could send the parties advance copies of requests for information, giving them a very short deadline (24 hours) to comment so as to help avoid vague, incomplete or misleading questions (and arguably discuss the matter with the Hearing Officer in a case of serious disagreement).

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- *Agreeing on evidence sought.* Similarly, the Commission could inform the parties when it decides to use external economic or technical expertise, giving the parties an opportunity to cooperate in providing the relevant background information, to comment on the premises and terms of reference of such studies and/or to commission their own independent studies.
- *Bringing the oral hearing forward.* In many instances, business has also complained that the S/O represents the moment when de facto the Commission makes a decision on the case. The oral hearing, which now follows the S/O, more often than not thus appears to offer minimal opportunity to change the Commission's views on the case. Bringing the hearing forward, or adding another hearing before the S/O is issued, might afford the parties a better opportunity to present their case before the Commission's services have reached their conclusions in the S/O.

### Conclusions

The ongoing recent debate on EC merger control has shown that this is one of the most contentious areas of the Commission's enforcement activities. We are fortunate that the ECMR provides for periodic reviews and that the Commission takes them seriously, being willing to discuss major issues and make major changes. In the past, the Commission has done so, notably abandoning the cooperative/concentrative distinction for jurisdictional purposes and adopting the new Article 2(4) ECMR test for joint ventures.

The authors submit that the Commission should consider changes again, this time mainly on the procedural side. Overall EC merger control has been a huge success story. It would be a pity if this should now be marred by continuing controversy about the procedural framework in which the Commission operates.

### Notes

- 1 Green Paper on the review of Council Regulation (EEC) No. 4064/89, COM (2001) 745/6 of December 11, 2001.
- 2 See, Cases M.2097, *SCA/Metsä Tissue*; M.2220, *GE/Honeywell*; M.2283, *Schneider/Legrand*; M.2187, *CVC/Lenzing*; and M.2416, *Tetra Laval/Sidel*.
- 3 Case M.2220, Decision of July 3, 2001.
- 4 Case M.2416, Decision of October 30, 2001.
- 5 See also Global Competition Review, June 2002, p 12.
- 6 Case T-342/99, *Airtours v Commission*, Judgment of June 6, 2002.
- 7 Case M.1524, Decision of September 22, 1999.
- 8 See Global Competition Review, February/March 2002, pp. 16-25.
- 9 Third parties' challenges to the EC courts have been more numerous although not very effective. Only two Commission decisions in merger cases have been annulled to date: joined Cases C-68/94 and C-30/95, *France v Commission* [1998] ECR I-1375 (the 'Kali und Salz' case); and Case T-156/98, *RJB Mining v Commission*, Judgment of January 31, 2001 (not yet officially reported).
- 10 Of those, one was subsequently withdrawn by the parties (Case M.993, *Bertelsmann/Kirsh/Premier*, Decision of May 27, 1998).
- 11 Case T-342/99, *Airtours v Commission*, Judgment of June 6, 2002.
- 12 *MCI WorldCom/Sprint* (Case M.1741, Decision of June 28, 2000), *GE/Honeywell* (Case M.2220, Decision of July 3, 2001), *Tetra Laval/Sidel* (Case M.2416, Decision of October 30, 2001) and *Schneider/Legrand* (Case M.2283, Decision of October 10, 2001).
- 13 OJ No. L 322/1, December 19, 2000.
- 14 OJ No. L 162/21, June 19, 2001.

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