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European Commission adopts merger control reform package

On 11 December 2002, the European Commission adopted a package of measures that would make important substantive and procedural changes in the EC merger control regime.[1] The package has three parts: a proposal for a Council regulation replacing the present EC Merger Regulation 4064/89 ("ECMR"), a draft Notice on the assessment of horizontal mergers, and draft "Best Practice" guidelines aimed at improving the parties' rights of defense and the Commission's decision-making process.

The reform package follows the debate launched with the Commission's December 2001 Green Paper on the Review of the ECMR, and the recent series of European Court of First Instance judgments overturning Commission prohibition decisions (*Airtours,*[2] *Schneider,*[3] and *Tetra Laval*[4]). The proposed guidelines and the proposed process reforms are an important step toward bringing more analytical rigor into the merger review process and improving the Commission's fact-finding and evaluation of mergers. While some further fine tuning may be needed, together, they should help improve the regulatory climate for merger and acquisition activity in Europe. In particular:

- **The package will bring the EC's substantive merger analysis more in line with that in the US. In particular, it will allow for consideration of efficiencies, and for unilateral effects in non-collusive oligopolies even where the transaction does not create a market leader.**
- **Important procedural changes include more flexibility for companies in deciding when to file merger notifications; a pre-notification process for allocation of jurisdiction between Member States and the Commission; and provision for limited extensions of time for complex cases and for evaluating proposed remedies.**
- **Other significant changes which will not require amending the ECMR include giving the merging parties earlier access to the Commission file, implementation of a formal system of "peer review" within the Commission, and appointment within DG Competition of a Chief Competition Economist.**

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[1] *See* Commission Press Release IP/02/1856 of 11 December 2002. The Commission documents are available on DG Competition's website.

[2] Case T-342/99, *Airtours plc. v. Commission*, Judgment of the Court of First Instance of 6 June 2002; *see* WCP Bulletin of 7 June 2002.

[3] Cases T-310/01 and T-77/02, *Schneider Electric v. Commission*, Judgments of the Court of First Instance of 22 October 2002. *See* WCP Bulletin of 23 October 2002.

[4] Cases T-5/02 and T-80/02, *Tetra Laval BV v. Commission*, Judgments of the Court of First Instance of 25 October 2002. *See* WCP Bulletin of 28 October 2002.

The Commission expects the new Regulation to be adopted in time for it to enter into force on 1 May 2004, on the same date as the "Modernization Regulation" for non-merger cases,[5] and invites third parties to submit comments on the draft guidelines by 31 March 2003. Some of the non-legislative measures are included in a set of draft Best Practices that the Commission will publish for consultation in the coming weeks.

1. The key proposed changes to the EC Merger Control Regulation

The proposal for a new Merger Control Regulation includes important substantive, jurisdictional and procedural reforms. The most important proposed changes are:

- ***Amended substantive test***. The Commission has decided to retain the "dominance test" as the substantive legal standard for assessing mergers and not to switch to the "significant lessening of competition" (SLC) test, applied in the US, Canada and a number of other jurisdictions. However, the Commission proposes to amend Article 2 of the ECMR to effectively re-define the "dominance" test to extend to situations in which "the combined entity holds the economic power to influence appreciably and sustainably the parameters of competition,…, or appreciably to foreclose competition." The intent is clearly to include also "non-collusive oligopolies" that raise competition concerns, such as the merger between the number 2 and 3 players in highly concentrated markets, and thus to close a real or perceived gap in the traditional dominance test. But the wording chosen by the Commission ("appreciable" rather than "substantial", and the reference to foreclosure of competitors) could be read as extending the reach of the ECMR further than the SLC test.

- ***Allocation of cases***. The proposal introduces a simplified system for the referral of merger cases from the Commission to the Member States and vice-versa, under Articles 9 and 22 of the ECMR. The changes are designed in part to make the "one stop shop" in Brussels available in more cases, although the Commission abandoned its earlier proposal to take jurisdiction in every case in which a merger would otherwise have to be filed in three or more Member States.

  Key changes in the system include these: (a) the parties would have the right to request a referral at the pre-notification stage; (b) the Commission would have exclusive jurisdiction in cases where at least three Member States make a referral to the Commission under Article 22; (c) the Commission would have a "right of initiative" to invite Member States to make referrals under Article 22 or to require a referral under Article 9.

  The net impact of these proposals may be to make the Brussels "one stop shop" available in more cases – although the changes also make it easier for the Commission to refer cases to the Member States. It seems certain, however, that companies will find it more difficult to predict in advance which jurisdictions will ultimately review their merger, and may encounter additional delays in the pre-notification phase as Member States and the Commission engage in the ad-hoc determination of jurisdiction.

- ***"Triggering event" and deadline for notification***. The Commission, consistently with the International Competition Network's recommendations, proposes to abolish the

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[5] The Council reached political agreement on 26 November 2002, the final text is not published yet. A WCP Bulletin on the Modernization Regulation is forthcoming.

requirement that the deal be notified within a week from the conclusion of the binding agreement and to make the timing for notification more flexible, similarly to the US rules. This change will give companies more latitude in deciding when to trigger a Commission investigation of their merger, and may make it easier for companies that want to do so to coordinate the EC and US investigations.

- ***More flexible deadlines for Commission decisions***. The Commission proposes to make the timeframe more flexible in complex cases and in cases in which companies have proposed remedies to avoid a prohibition decision. Under the proposal, an automatic extension of the Commission deadline to adopt a final decision would apply in cases where the parties submit remedies (by 10 additional working days in Phase I cases and by 15 additional working days in Phase II cases). Moreover, the parties would have the right to request an extension by 20 additional working days in complex Phase II cases.

- ***Increased powers of investigation***. In line with the new Regulation for the enforcement of Articles 81 and 82 EC adopted on 26 November 2002, the proposal strengthens the Commission's fact-finding powers and grants the Commission the power to take oral statements to be recorded and used as evidence in proceedings where the interviewee consents. The ability to use oral statements, which have always been used extensively in US practice, should facilitate more efficient and thorough fact-finding by the Commission. The new Regulation does not empower the Commission to search companies' representatives' private homes, as the "Modernization Regulation" does in non-merger investigations.

- ***Ancillary Restraints***. Following the recent Court of First Instance ruling in *Lagardère/Canal+,*[6] the Commission proposes to modify the ECMR to state that the Commission's clearance decision in a merger case "shall be deemed to cover restrictions directly related and necessary to the implementation of the concentration." This change would give the Commission a firm legal basis for its recent practice of refusing to make explicit findings on the ancillary nature of restrictions such as non-compete clauses.

2. Draft Notice on the assessment of horizontal mergers

The Commission has issued the first in a series of guidelines as to its analysis in merger investigations. The first draft deals with horizontal mergers, *i.e.*, mergers between competitors. Draft guidelines on conglomerate and vertical mergers are to be published next year. The current draft Notice's approach is consistent with that of the US antitrust agencies' horizontal merger guidelines. Consistently with the US approach, the Commission has said it is unlikely to challenge a horizontal merger if the post-merger HHI remains below 1000.

Interpretation of the dominance test: The draft Notice identifies three ways in which horizontal mergers may have anti-competitive effects, *i.e.*, significantly impede effective competition as a result of the creation or strengthening of a dominant position:

- *Single firm dominance*. A merger may create or strengthen a "paramount" market position by eliminating a competitor, with the result that the merged entity is able to raise

[6] Case T-251/00, *Lagardère and Canal+ v Commissio*n, Judgment of 20 November 2002. *See* WCP Bulletin of 25 November 2002.

prices or decrease output with no constraint by customers or competitors. The Commission notes case law under which a combined market share over 50% is evidence of dominance, especially when the merged firm's rivals are considerably smaller. However, other factors may be taken into account in assessing whether a firm with either more or less than a 50% market share in fact has market power, including the extent to which the merged firm has competitive advantages (such as access to leading technologies, ownership of the most important brands, customer loyalty), and the extent to which there are countervailing factors such as new entry, buyer power, efficiencies or a failing firm defense. Most importantly, the guidelines provide that the Commission will examine whether the firm will face sufficient competition from other firms in the market so as to make it unprofitable for the merged firm to increase prices or decrease output before finding that the merger will create or strengthen a dominant position.

- *Non-collusive oligopolies*. These mergers diminish competition in an oligopolistic market by eliminating important competitive constraints on one or more suppliers, who would find it profitable to increase prices or reduce output post-merger. The level of concentration is the most important factor in assessing these oligopolies. The Commission distinguishes between mergers involving homogeneous and differentiated goods and between mergers in industries in which competition is driven by output and those in which it is driven by price. (This distinction is based on the Cournot and Bertrand models of oligopoly; under these models, mergers in industries in which price is the key strategic variable are less likely to result in sustainable price increases than mergers in which output is the key strategic variable.) When a merger concerns relatively homogeneous goods, the Commission is likely to open a second-phase investigation if the merger leads to an aggregate HHI index of 2000 or more and an increase in HHI of 150. If the products are differentiated, the Commission will primarily consider the degree of substitutability between the goods. In assessing the impact of the merger, the Commission will consider whether the parties have the ability and the incentives to reduce price or output. In determining this, the Commission will examine the ability and incentive of rivals to increase output in response to an increase in price or reduction of output by the merged firm and, in the case of differentiated products, the ability of rivals to reposition their products to become closer substitutes to the products of the merging firms. The Commission is unlikely to be concerned about mergers involving differentiated markets if the merging firms' market share is not above 25%.

- *Collusive oligopolies*. These are mergers that give rise to an increased risk of coordination among competitors in the market. The Commission's Notice adopts the three conditions indicated by the Court of First Instance in its *Airtours* decision. First, the firms must be able to establish terms of coordination. Second, they 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. This will depend on the degree of transparency in the market. Third, they must have credible and timely deterrent mechanisms at hand in order to prevent deviation from the coordinated outcome. In addition, the actions of current and future competitors, as well as customers, must be unlikely to jeopardize the gains expected from the coordination, a factor that will depend on issues such as ease of market entry and countervailing buyer power.

Efficiencies. The draft Notice confirms that the Commission will consider efficiencies in its assessment of mergers. This is an important acknowledgement, and is a response to persistent complaints that the Commission's past attitude toward efficiencies has at times been to penalize efficiency-enhancing mergers for giving the merged firm advantages over less efficient rivals.

The Commission will consider efficiencies that (1) directly benefit consumers in the relevant market (*e.g.*, cost efficiencies leading to reductions in variable or marginal costs are more relevant than reduction in fixed costs); (2) are merger specific (*i.e.*, are a direct consequence of the merger); (3) are timely; and (4) are verifiable. The merging parties have the burden of demonstrating why the efficiencies will counteract any adverse effect on competition and directly benefit consumers. The Commission says it is very unlikely that efficiency arguments would lead it to clear a merger creating a monopoly or quasi-monopoly. In one respect the Commission's criteria may be more generous than those in the US guidelines: the Commission's requirement that the efficiencies be a direct result of the merger does not expressly include a requirement that they could not be achieved through other means.

Nevertheless, the Commission seems to leave the door open to an "efficiency offense" in some cases. The Commission identifies a number of factors the Commission will take into account in assessing the merged company's "economic power," including economies of scale and scope; "privileged" access to a supply of upstream products through vertical integration or otherwise, particularly effective distribution and sales networks; access to important facilities or technology; and "privileged" access to physical or financial capital. The Commission acknowledges that these factors are likely to benefit customers, but said they will nevertheless raise concerns if they make it hard for competitors to constrain the merged firm's ability to raise prices or decrease output.

Failing firm defense. The Commission indicates, in line with the European Courts' case law and its own recent practice, that it will accept a "failing firm defense" when the following three criteria are met: (a) the acquired undertaking would be forced out of the market in the near future because of financial difficulties if not taken over by another undertaking; (b) there is no less anti-competitive alternative purchase than the notified concentration; (c) absent the merger, the assets of the failing firm would inevitably exit the market.

The Commission has launched a public consultation and invites third party comments on the draft Notice by 31 March 2003.

3. Other non-legislative measures

The Commission announced in its Press Release of 11 December 2002 that it will adopt a series of non-legislative measures designed to improve the quality of the Commission's decision-making in merger cases as well as companies' rights of defense. The main measures include: (a) giving the merging parties the right to examine the Commission's file at the beginning of a Phase II investigation, rather than only after a Statement of Objections has been issued; (b) the creation of a post of Chief Competition Economist in the Directorate-General for Competition to be involved both in merger and antitrust investigations; (c) for Phase II merger investigations, appointment of a review panel composed of experienced officials, whose task it will be to scrutinize the investigating team's conclusions with a "fresh pair of eyes" at key points of the enquiry; (d) increasing the support staff to the Commission's Hearing Officers; (e) having regular "state-of-play" meetings between merging parties and the Commission at decisive points in the procedure, to guarantee that the merging parties are kept constantly apprised of progress in the investigation and to give them an opportunity to discuss the case with senior Commission management.

Some of these non-legislative measures will be detailed in a set of draft Best Practices which the Commission will publish for consultation, probably not until January 2003.

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