15 December 2003

Member States Agree on new EC Merger Test

On November 27, the Member States of the European Union reached unanimous political agreement on reform of the EC Merger Regulation. The new substantive standard for antitrust assessment of mergers is whether a transaction "significantly impedes effective competition . . . in particular as a result of the creation or strengthening of a dominant position." The reform, which the European Union must still formally adopt and which will take effect in May 2004, also introduces important procedural changes.

The new substantive standard is a hybrid of the United States' "substantial lessening of competition" test and the EU's current "dominance" test. Whether it changes or merely clarifies existing law is European Union's subject to debate. Under either view, the new test provides a clearer basis for Commission challenges to mergers that do not create a dominant firm position, but are seen as likely to raise prices through non-collusive oligopoly effects. At the same time, the new test may lessen the risk of challenge to mergers that create or strengthen market leadership, but are not likely to harm consumers.

Background

The EC Merger Regulation (the "Regulation"), which was first adopted in 1989 and amended in 1997, is the legal basis for the European Commission's antitrust review of mergers. To remedy perceived shortcomings, the Commission initiated the current reform with a public consultation in December 2001. The reform gained additional momentum from three judgments of the European Court of First Instance in 2002, that annulled Commission decisions prohibiting the mergers of Schneider/Legrand, Tetra Laval/Sidel, and Airtours/First Choice. The new Regulation, which will be made public after formal adoption which is expected before the end of this year, will become effective on May 1, 2004, when 10 Eastern European and Mediterranean countries will join the European Union and other important changes to EC Competition law will also take effect.

The amendment of the EC Merger Regulation is part of a wider reform of the EC merger control regime. The Commission has already implemented a package of non-legislative reforms, such as the appointment of Lars-Hendrik Röller as the Commission's Chief Economist for Competition. The Commission has also published draft administrative Guidelines on the appraisal of horizontal mergers (see WCP comments) and a set of best practices for conducting merger investigations (see WCP comments), both of which are expected to be finalized shortly. Additional guidelines are expected in 2004, most notably covering the appraisal of non-horizontal mergers.

The New Substantive Test: Significant Impediment to Effective Competition

The most controversial aspects of the reform discussions concerned the substantive merger control test, which currently prohibits a merger if it "creates or strengthens a dominant position as a result of which effective competition would be significantly impeded."

Critics of the "dominance" test argued that it leaves an enforcement gap for mergers in oligopolistic markets when the merged entity could raise prices unilaterally even though it is not the market leader and without tacitly colluding with competitors. Some also criticized the dominance test for over-emphasizing market structure and failing sufficiently to take into account the actual market effects of a merger.

The "substantial lessening of competition" or "SLC" test, which the United States, the United Kingdom, Ireland, and some non-European jurisdictions apply, focuses on the likely economic outcome of the transaction rather than on market structure. By the time of the Council vote, many observers believed that the Commission favored an SLC test, but it faced resistance from practitioners and Member States who argued that any benefit from such a change was small, and that abandoning the dominance test would jeopardize the legal certainty created by the existing body of precedent. Furthermore, some Member States – especially Germany – were reluctant to depart from the dominance test because it had been incorporated in most Member States' antitrust laws.

The new test will prohibit mergers that "significantly impede effective competition . . . in particular as a result of the creation or strengthening of a dominant position." This test is similar to that currently applied in France, which asks whether a merger jeopardizes competition (*"porter atteinte à la concurrence"*) and refers to the creation or strengthening of dominance as the major case where that could occur.

The new test is similar to the SLC test, but it is not yet clear whether the different wording will produce differences in outcome. It seems clear, in any event, that the test will support Commission challenges of transactions that create oligopolistic markets, when the merged firm is likely to raise prices post-transaction, even when the merged firm will not hold a dominant market position. The most prominent example of this scenario is when the merging firms are especially close competitors in a market characterized by differentiated products. (This is akin to the concept of unilateral effects in U.S. antitrust analysis.)

The Commission is expected soon to issue its notice on the appraisal of horizontal mergers, revising the draft it circulated last year and setting out its interpretation of the new test. Guidelines for non-horizontal mergers will follow next year. These guidelines will have a greater bearing on merger counseling and enforcement than the bare language of the statute and will greatly influence how the Commission applies the new test and whether it leads to outcomes that are significantly different than those reached under the current EU dominance test.

Procedural Amendments to the Merger Regulation

The ministers also agreed on other amendments to the EC Merger Regulation that the Commission proposed. The most important ones involve:

- The extension of the Commission's investigative powers, including the right to inspect company premises and question executives who are present;

- More flexible timing for notifications, thereby allowing companies to notify a merger anytime if they can demonstrate a serious intent to merge; companies will no longer have to wait until a formal agreement is entered into or a public bid launched (this is similar to the US rule);

- More flexible time limits, including two possible extensions of time for the Commission to adopt a final decision in Phase II investigations -- a three-week extension (automatic if

remedies are submitted) and a four-week extension (on request of the parties or the Commission, if the parties agree);

- Modifications to the system of allocating merger cases between the European Commission and Member States. These modifications include (a) facilitating referral decisions before the formal filing of notifications, and (b) allowing companies to request that the Commission investigate a merger if the merger would otherwise have to be notified in three or more Member States.

Additional information on the initial Commission proposal and the other reforms is available in the Commission press releases of December 2002 and November 2003.

* * *

This Bulletin has been prepared by Chuck Stark and Axel Gutermuth. If you have any questions about the reform of the EC merger control system, please do not hesitate to contact them or any of the lawyers listed below.

WCP ANTITRUST AND COMPETITION GROUP

In Brussels: ***+32 (2) 285.49.00***

Claus-Dieter Ehlermann	**Christian Duvernoy**	**Antonio Capobianco**	**Jan Heithecker**
John Ratliff	**Yves Van Gerven**	**Pablo Charro**	**Lorelien Hoet**
Charles Stark	**Sven Voelcker**	**Axel Desmedt**	**Anne Vallery**
Paul Von Hehn	**Frédéric Louis**	**Flavia Distefano**	**Naboth van den Broek**
Marco Bronckers	**Eric Mahr**	**Martin Goyette**	**Deirdre Waters**
Thomas Mueller	**Natalie McNelis**	**Axel Gutermuth**	

In Berlin: ***+49 (30) 20.22.64.00***

Karlheinz Quack	**Rainer Velte**	**Stefan Ohlhoff**	**Andreas Zuber**
Ulrich Quack	**Markus Hutschneider**	**Hartmut Schneider**	**Alexander Juengling**
Natalie Luebben	**Joerg Karenfort**	**Ruediger Schuett**	

In Washington, DC: ***+1 (202) 663.6000***

William Kolasky	**Ali Stoeppelwerth**	**Nicole Berry**	**David Olsky**
Douglas Melamed	**Leon Greenfield**	**Aaron Brinkman**	**Jeffrey Rogers**
Robert Bell	**Jeffrey Ayer**	**Richard Elliott**	**Jeffrey Schomig**
Veronica Kayne	**Janet Ridge**	**James Frost**	
John Rounsaville	**Yaa Apori**	**Jacqueline Haberer**	
James Lowe	**Laura Batenic**	**Ron Katwan**	

All attorneys can be reached via email by first name.last name@wilmer.com