After Three Losses, Super Mario Strikes Back

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European Merger Control After Three Lost Court Battles: Revolution or Evolution?

The year 2001 was the high watermark of European merger control. The European Commission prohibited an unprecedented five transactions, most prominently the $44 billion merger between General Electric and Honeywell. Competition Commissioner Mario Monti, dubbed "Super Mario" by the media, stood firm against public pressure from industry icons and heads of state, while his Merger Task Force posted an unofficial logo on its website of a sheriff star framing a ravenous piranha.

By year-end 2002, EC merger control presents a completely different picture. For the first time ever, and in three consecutive cases within a few months, the European Court of First Instance annulled Commission decisions prohibiting mergers (*Airtours/First Choice*, *Schneider/Legrand*, and *Tetra Laval/Sidel*). In unusually clear language, the judgments painted a picture of a poorly organized merger review process, where evidence was not carefully compiled and decisions were hastily put together without sufficient factual basis. In November, pushed by growing criticism, Commissioner Monti announced significant reforms to the EC merger control process, adding to pre-existing proposals to fine-tune the EC Merger Regulation in various other respects.

The events of 2002 affect the EC merger review system in five ways.

1. More checks and balances. A principal criticism of the merger review regime has been the Commission's multiple role as investigator, judge, jury and executioner—a combination of responsibility that led to an unsound concentration of power in the hands of the Merger Task Force's case teams. Commissioner Monti's reform aims at improving the checks and balances on the case teams in four ways.

- The Commission will create the position of a Chief Economist, who will be an eminent economist reporting directly to the Competition Commissioner. He will provide an independent economic viewpoint on merger and other competition cases and give guidance throughout the investigative process. The Commission has not yet decided whether the Chief Economist's staff members will form a parallel case review pillar as in the US, be integrated in case teams with other officials of the Merger Task Force, or merely be consulted at some stage of the procedure.

- High-level peer review panels will be introduced to scrutinize the Merger Task Force's preliminary conclusions with a "fresh pair of eyes" at key stages of in-depth merger investigations. A panel would be composed of experienced competition officials and sometimes other Commission officials.
- The existing Hearing Officer's powers will be expanded and she will be equipped with additional resources to improve her ability to ensure the respect of the parties' right of defense.
- The merging parties will have better access to the Merger Task Force's file and case team.

These reforms, which will be implemented as soon as possible without requiring legislative action, undoubtedly will contribute to sound decision-making, but two points of caution are necessary. First, no control can be effective without three critical ingredients: access to the facts of the case, access to the parties, and the ability to influence the case team's decision. The existing control mechanisms either lack the ability to challenge the Merger Task Force or familiarity with the facts of these extraordinarily complex cases. It is not clear whether the current proposal materially improves that situation. Second, additional layers of institutionalized review add complexity, bureaucracy, and the risk of power struggles. The Merger Task Force, the peer review panels, the Chief Economist, the Commission's Legal Service, the other Commissioners, and the Member States will all have a say in future merger cases. It remains to be seen where power and influence will *de facto* reside.

2. Broader substantive test and efficiency defense. The court judgments do not question the substantive theories advanced by the Commission in the past to challenge mergers. *Airtours/First Choice* confirms and fine-tunes the theory of collective dominance, while *Tetra Laval/Sidel* recognizes the contested conglomerate leveraging theory, which alleges that mergers harm competition if the merged firm can use its dominance in one market as a lever to gain dominance in a second separate market. The Court will review the leveraging theory again in the pending *GE/Honeywell* appeal, but will likely uphold its theoretic foundation. Merging companies will therefore continue to confront the full panoply of single and collective dominance, vertical leveraging, and conglomerate and range effects, to name just the most prominent theories.

The only major issue not yet addressed by the EC courts (and, indeed, the Commission) is whether the dominance test also covers unilateral effects in a transaction that does not involve or create the market leader. Commissioner Monti wants to amend the wording of the dominance test to make sure it embraces such unilateral effects. He has rejected, however, to move to an US-style "substantive lessening of competition" test.

Efficiencies will play a growing role in the substantive review of merger cases, as the Commission now appears prepared to accept efficiencies as a defense to an otherwise anti-competitive merger. In the past, merging parties often complained that efficiencies were used against them, as the Commission argued that efficiencies would enhance the ability of the merging parties to compete and therefore entrench their competitive advantage over competitors, possibly creating or strengthening dominance. The recognition of efficiencies as a defense will alleviate that concern.

3.Greater emphasis on economics, facts, and evidence. The court judgments illuminated and overtly criticized two shortcomings of the Commission prohibition cases: insufficient investigation and handling of factual evidence, and insufficient economic reasoning. In *Airtours/First Choice*, for example, where the creation of collective dominance between the leading UK foreign package vacation operators was at stake, the Court of First Instance criticized that the Commission made a "series of incorrect findings", that it prohibited the transaction "without proving that it would actually have an adverse effect on competition", and that its decision was therefore "vitiated by errors relating to factors fundamental to any determination" of collective dominance.

All three judgments demand a more rigorous merger assessment based on an analysis of the likelihood of specific anticompetitive effects, rather than a generalized assessment of market structure, which has traditionally emphasized factors such as market shares and market concentration. In *Airtours/First Choice* , the Commission viewed as essential to its analysis that the market structure moved from four to three major competitors and provided strong incentives for the three to align their competitive behavior (without explicitly agreeing to do so). The Court held that the Commission should have analyzed better whether anticompetitive effects could nonetheless be prevented, for example because the three would not have an effective possibility to punish cheaters within their group, or because consumers could move to smaller competitors in reaction to any price increase of the leading three.

These developments require the Commission to intensify its investigations, take a much closer look at the facts of complex cases, and expand the economic analysis. As a footnote, it should be noted that Commissioner Monti is a highly regarded economist himself, who has been instrumental in fostering the fast-growing importance of economics and economists in EC competition law. Philip Lowe, the new Director-General for Competition, is also an economist, and, as a former head of the Merger Task Force, will have the interest and professionalism to review the process so that the high standards being required by the Court are met.

4. Better chance of effective court review. The judgments have shown that a merger prohibited by the Commission may with some limited additional reforms have a realistic chance to get timely and effective court review. Timeliness of court review dramatically improved by the introduction of a fast-track appeal procedure in 2001, allowing the Court of First Instance to decide an appeal against a Commission prohibition decision in months rather than years (approximately twelve months after the prohibition decisions in the *Schneider/Legrand* and *Tetra Laval/Sidel* cases). The effectiveness of court review has improved because the judgments have reconfirmed and emphasized that the Court of First Instance will take a fresh and deep look at the factual evidence to determine whether it supports the articulated theory of competitive harm, rather than simply deferring to a seemingly rational forward-looking theory stated in a Commission decision.

However, court review in its current form will not work for many prohibited mergers. The workload restraints at the Court of First Instance in its current form limit the number of fast-track procedures at any given time. To be timely, court review should ideally be terminated within six months from prohibition. In addition, even timely court review will only have a real commercial impact if the Commission also quickly reassesses the transaction in light of the Court's decision—the Court cannot itself clear a merger, but only annul the Commission's prohibition and thereby reset the administrative review at the beginning. If the Commission does not take guidance from the Court's decision, but instead sees the annulment as an opportunity for a "do-over," then the timeliness of judicial review will be eviscerated.

If the Commission and the Court are able to establish effective and timely review, then they will have retained the predictability and transparency of the current administrative regime, while incorporating a commercially realistic check on that decision-making. They will have combined the best features of the current EC and US merger review systems.

5.Closer US/EU coordination. In September 2002, the Commission and its US counterparts agreed to coordinate even more closely on merger cases pending in both jurisdictions. They will align timelines, exchange factual information, and discuss the merits of cases to the maximum extent possible. This will, *de facto*, add a layer of external peer review on the Commission. Closer coordination will also lower the risk of diverging decisions.

These developments are not a revolution. They will make the EC merger clearance system better, but not easier to navigate. The improved checks and balances will more effectively safeguard against ill-prepared decisions, but the scope of the substantive review remains intact and will even broaden. The Commission and the parties will argue cases more on specific facts, and the importance of economics and economists will grow significantly. Such discussion can only come with much more detailed and probing investigation. This will produce more data and will require more resources on both sides to assess it.

Merging parties can best adapt to the new system by investing early in self-assessing the facts of the case, marshalling the probative evidence and working out the economics. Closing conditions and drop-dead dates could be drafted to allow for court review (and a remand to the Commission). Certainly, the battle of arguments will be intense. But the law will not be dispensed in the style of the old west: the Merger Task Force's sheriff star has disappeared.