



REFORM OF EUROPEAN MERGER POLICY

by

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Abstract

This article highlights the main drivers for merger policy reform in the EU, including the consequences of the recent appeal court reverses. It discusses some of the substantive and procedural issues that the reform package should address, and outlines the reforms in progress. The article concludes that much of the reform package will be beneficial, but some important opportunities have been missed in this inevitably patchwork process. The two most important omissions are the failure to separate Phase I and Phase II investigation teams, and the unnecessarily complex preservation of the dominance test.

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1. Introduction

The globalization of industry has inevitably drawn attention to comparisons of national (and one supranational) competition agencies. The same firms face different agencies around the world, and increasingly the same merger is appraised by several agencies at once. There is very strong coordination of policy and agencies within Europe, particularly between the European Commission and the EU member states. There is also considerable transatlantic cooperation, but differences remain both in the substantive appraisal of mergers and in merger review procedures.

A recent survey by Global Competition Review rated the USA as having the best set of agencies, followed by the UK and Germany, with the EU's DG Competition (DG Comp) a creditable but 'could do better' fourth best. Of course, such practitioner surveys must be treated cautiously because they are based on the responses of knowledgeable but vested interests. Nevertheless, a closer look at the pressures facing DG Comp, and the long list of current and forthcoming reforms, suggests that the institution appreciates certain weaknesses, and is capable of self-criticism and reform. Are these reforms in the right direction? Are the reforms sufficient to address all the weaknesses in current procedures? Are they sufficient for DG Comp to move up the competition agency league table? And most importantly, will they improve the economic analysis behind its decisions?

In this paper, I provide a very brief sketch of the legislation and institutions of merger policy administered by the European Commission (section 2), and highlight some of the pressures for reform (section 3). These include some very high profile reverses in the appeal court. The next two sections highlight the key issues that might cause problems in merger appraisal, particularly when jurisdictions differ in their approaches. These relate both to substantive issues such the test against which mergers must be appraised (section 4), and procedural and organizational issues such

as the publication of merger guidelines and the separation of functions between agencies within each jurisdiction (section 5). Where relevant, I provide a brief comparison between the (pre-reform) EU, US and UK. Following an outline of the numerous reforms that have recently been announced (section 6), I conclude with a brief overall assessment of the state of reform (section 7).

2. European Legislation and Institutions

Merger control at the EU level was only agreed in late 1989 with the European Communities Merger Regulation (ECMR, 1989). It was implemented during the following year. The scope of the ECMR picks up any merger with a ‘Community dimension’.¹ This is defined sufficiently broadly to include most large scale mergers of firms making significant sales in at least two Member States. Note that this includes mergers between firms that produce entirely outside Europe, but which sell into Europe (e.g. primary producers). There are powers to refer a merger back to a Member State for review if that is thought appropriate.

A point of major interest is the test by which mergers are appraised. Article 2(3) of the ECMR states: ‘A concentration [i.e. merger or acquisition] which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it shall be declared incompatible with the common market’. This is commonly referred to as the Dominance Test (DT).²

In section 4.1, I compare the unmodified DT with the USA legislation, which prohibits any acquisition, the effect of which ‘may be substantially to lessen

¹ Mergers include acquisitions and ‘full function’ joint ventures (i.e. those which could in principle stand alone from their parents). Joint ventures account for approximately half of all mergers investigated under the ECMR.

² In January 2003, the Commission published a proposed modification/clarification of the DT. This is discussed in section 6.

competition, or to tend to create a monopoly' (Clayton Act #7, 1914). The US test is referred to as the SLC test, which is currently interpreted as 'whether the merger is likely to create or enhance market power or to facilitate its exercise' (US Merger Guidelines, 1997). The European test clearly has a much shorter history than the US, but it is derived from a longer tradition in Germany and also echoes the wording of Article 82 of the Treaty of Rome (1957), which prohibits the abuse of an existing dominant position.

A second, and unique, difference between the objectives in the EU and the USA is that, in all matters of competition, the Commission is concerned with market integration. Even post introduction of the Euro, this is still very much less advanced in Europe than in the USA, and it remains an overarching objective. However, this impinges much less on mergers than on other aspects of competition policy, most notably policy towards parallel imports and the control of state aids.

Turning to institutions, DG Comp is the agency charged with enforcing all aspects of EU competition policy (including state aids). A separate department within DG Comp, called the Merger Task Force (MTF), was established at the outset of the ECMR, and this was charged with all merger investigations. It soon established a reputation as an elite group within DG Comp.³

Each Directorate General (DG) in the European Commission is headed by a politically appointed Commissioner (Mario Monti currently heads DG Comp), but all other appointments are non-political career civil servants. Merger review in the MTF is in two phases. Phase I must be completed within a month, rising to six weeks if a Member State intervenes or if the parties offer a remedy at this stage. If the merger raises serious doubts, Phase II proceedings are initiated and a further four months are

³ As discussed in section 6, the MTF's reward (or come-uppance?) is that it is being disbanded as part of the recent reform package.

allowed for a final decision. This very precise set of administrative deadlines differs from the more elastic US system.⁴ Formally, DG Comp makes a recommendation to the full set of 20 European Commissioners (most of whom have no expertise in competition matters) who decide whether or not to accept the recommendation.

The parties to a merger can appeal to the Court of First Instance (CFI). A further appeal, limited to legal questions, may also be possible to the European Court of Justice (ECJ). Both are traditionally lengthy processes, and business realities mean that it is extremely difficult to resurrect a negative merger prohibition that has been overturned on appeal. Thus, the European merger procedure is very much more distant from the courts than is the US procedure, where the courts cast a continual shadow on the FTC or DoJ, even when the parties settle out of court. Both sides in the US system must continuously ask themselves: ‘how would the courts interpret the evidence we are providing to support our arguments?’. In contrast to the USA, the court in Europe does not attempt fact finding. The question it asks is one of judicial review, so DG Comp must continuously ask itself: ‘would the court find that we have failed to adopt the correct procedure in collecting evidence, and have we been sufficiently diligent in trying to interpret it?’.

This very brief comparison of objectives and institutions is highly stylised. Its purpose is to provide some essential background for the discussion of reform. It is not intended to be in any way comprehensive or delicately nuanced.

3. Drivers for Change

Numerous changes in European merger control are being implemented around the time of writing (2003). A ‘clarification’ has been proposed for the dominance test against which all mergers must be appraised. Devil’s advocate panels are providing

⁴ The UK system also has tight administrative deadlines.

an internal critique of the arguments provided by case teams. A new post of Chief Economist has been created and filled by an academic economist. For the first time, there is a published set of draft merger guidelines which explain the circumstances in which a merger might be expected to result in competitive harm. There is an extended timetable to allow more time to develop remedies that are appropriate to the expected competitive harm. And the Merger Task Force (MTF), previously a separate unit in DG Comp that undertook all merger inquiries, is being dismembered and folded into other, mainly sectoral units. What has prompted all these changes at this moment in time?

Successful appeals to the Court of First Instance against Commission decisions

One explanation, advanced by some of the press, is that reform has been a panic response to a series of high profile reverses in the European Court of First Instance (CFI). These successful appeals against three merger prohibitions in quick succession have certainly been a substantial shock to DG Comp. Until this five month period during 2002, the MTF had survived nearly all such challenges.⁵ While the timing appears to fit nicely with the panic theory, this view is substantially false. The reform train had been motoring long before any of these cases, and a Green Paper (i.e. a formal consultation document) on Merger Reform had been published in December 2001. Nevertheless, it is probably true to say that the CFI reverses have been influential in affecting much of the detail. It would go beyond the purpose of this paper to provide full details of each case, but the main problems identified by the three successful appeals are:

⁵ There is only one comparable earlier reverse, with judgment being passed by the ECJ. The Commission's remedies (December 1993) attached to Kali & Salz's proposed merger with Mdk resulted in an annulment by the Court (in March 1998) on the grounds of insufficient evidence to support a finding of collective dominance. The outcome of a further eagerly awaited appeal, in relation to GE-Honeywell, is expected probably no earlier than 2005 (the original decision was in July 2001!).

- *Airtours/First Choice*: DG Comp did not conduct a sufficiently rigorous economic analysis of the incentives for and ability to coordinate behaviour as a direct consequence of the proposed merger, which they prohibited on the basis of coordinated effects.⁶
- *Schneider/Legrand*: DG Comp failed to take account of the different degrees of competition in each of the national markets it identified, and did not provide Schneider with enough information to offer an appropriate remedy.⁷
- *Tetra Lavel/Sidel*: DG Comp should have: a) taken account of the fact that its concern over leveraging market power between two otherwise separate markets would have required tactics that are illegal under Article 82; b) provided a proper appraisal of behavioural commitments before resorting to its favourite structural remedy (divestiture); and c) adopted a higher standard of proof.

Whereas *Airtours/First Choice* and *Schneider/Legrand* were accepted by DG Comp as bearing mainly on the particular case in question, without necessarily creating a major precedent,⁸ the result of the *Tetra Lavel/Sidel* was different. Each of the Court's findings in *Tetra* could be incredibly damaging to effective merger control, and DG Comp immediately appealed to the European Court of Justice. It is, however,

⁶ Newspaper reports now suggest that MyTravel (the renamed *Airtours*) is now suing the Commission for £518m in damages (*Financial Times*, 20th June 2003). This could break major new ground if it were to create a precedent for damages following a successful appeal in a competition case.

⁷ If *Schneider* were to sue, it might claim €1b in damages (*Financial Times*, 20th June 2003).

⁸ In fact, *Airtours/First Choice* potentially set a major precedent in its association of collective dominance with a particular economic model of tacit collusion.

unfortunate that this important test case is based on the highly contested economics of leverage.

Although I have argued that reform was already under way before these appeals, this does not mean that they have not had an important effect on the conduct of merger investigations. A brief statistical analysis is suggestive, care must be taken in interpretation, especially as the volume of merger activity varies from year to year. Also, mergers whose harmful effects cannot be remedied by divestiture or some other undertaking are relatively unusual, so short period averages can be misleading. Nevertheless, the statistics are consistent with a chilling effect of the successful appeals on the propensity to prohibit mergers. In the first full decade of merger activity (1991-2000), there were 13 prohibitions out of 1,498 decisions (i.e. a prohibition rate of 0.87%).⁹ In 2001, there were five prohibitions, including GE/Honeywell, Schneider/Legrand and Tetra-Lavel/Sidel, out of 340 decisions (i.e. a prohibition rate of 1.47%). The three successful appeals mentioned above were announced by the CFI between June and October 2002. The Commission adopted no prohibitions during 2002 or in 2003 (at least up to the time of writing at the end of August), during which period there were 430 decisions.

Beyond any immediate impact on the self-confidence of DG Comp, it is clear that the appeals raise a range of concerns, including inadequate economic analysis and procedural weaknesses. DG Comp has appealed to the higher court in only one case, thereby indicating an acceptance of much of the implied criticism.¹⁰ The CFI judgements have given impetus to the reform process which was already in place following the Green Paper. As a result, the reforms have been hastened and sharpened, but this does not make the appeals into the main drivers for reform. There

⁹ These figures omit 7 decisions in 1990 when the MTF was just starting its work. Each of these very early decisions cleared the mergers in Phase I without any commitments being required.

¹⁰ It also reflects the limited grounds of appeal, limited to the law only, at this higher stage.

were three longer term forces that had been pushing hard for some time: maturity in merger regulation; increasing use of economic analysis; and expanding membership of the EU.¹¹

Mature reflection

Enormous experience had been derived during the first decade of the MTF. Inevitably, lessons had been learned and it would be surprising if change was not necessary. As it happens, many of the lessons had been positive, about best practice that could be applied elsewhere. The MTF quickly gained the reputation as an elite unit within DG Comp, especially in comparison with the slow administrative approach in sectoral units applying antitrust Articles 81 and 82 or in the state aids units. There is virtue in spreading good practice, and also in integrating the economic approach to competition throughout all branches of competition policy. Other aspects of reform, such as the merger guidelines, follow from over a decade's experience. Prior to facing a wide range of cases and problems, it would have been hard to write anything meaningfully directed at the EU's particular legal, administrative and economic circumstances.¹²

Increasing use of economic analysis

Economic analysis is used increasingly to inform competition decisions across the globe. All agencies must think hard about how to rise to the challenge of integrating top class economic analysis more centrally into merger appraisal. It is an

¹¹ A further, more technical, motivation was to clarify and possibly extend DG Comp's jurisdiction, especially on mergers below the turnover threshold, but affecting several member states.

¹² State aids are also subject to notification deadlines. An important difference is that addressees of the state aid decision are Member States and not firms.

entirely positive motive for institutional reform to address this very desirable global trend. From this perspective, the appointment of a Chief Economist is long overdue.

Ten new member states from May 2004

This is the motive for many of the changes being mooted for EU institutions, from the ECB Governing Council to a European Constitution. It is also a concern for DG Comp, because a large increase in case load is expected. Much of this might relate to state aids, but there will also be merger and antitrust concerns in national geographic markets until the typically small new members on the perimeter of the EU become more economically integrated. DG Comp needs more efficient procedures to deal with this. It is also sensible for reforms to be in place prior to the administrative effort necessary to integrate the new members into the routines of the European Commission.

4. Substantive Issues in Merger Policy Reform

This section highlights two substantive issues that link the law and economics of merger policy. Should the EU abandon the DT in favour of something closer to the SLC test? And how should efficiencies be treated in merger appraisal? I briefly raise a third topic that has not yet entered the economics debate, but which can be important in practical cases. How should appraisal proceed in the face of ignorance about a potential economic mechanism?

4.1 Why the SLC (or SIEC) Test Is Better Than the Dominance Test

I have already noted the difference between the EU and US tests against which mergers must be appraised. The ECMR states that a merger should be prohibited if it:

- a) creates or enhances a dominant position; ...*as a result of which there is*

b) a significant impediment to effective competition (SIEC).¹³

This is known as the Dominance Test (DT). The problem is that this test can lead to both type I and type II errors. First, it can be too harsh on merging parties because an efficiency enhancing merger might be wrongly prohibited. This can arise if it harms rivals and so ‘creates’ a dominant position. Of course, a proper application of b) should not result in prohibition if overall competition is not impeded, and very recently Commissioner Monti has declared that efficiency enhancing mergers should not be caught by the DT.¹⁴ Nevertheless, there is still a strong suspicion that dominance *per se* matters. This encourages a wasteful and costly line of lobbying by rivals, and it encourages investigators in DG Comp to focus unduly on a) when b) is what matters.

Second, the DT can be too generous on merging parties by allowing anti-competitive mergers. This is because a) creates an essential hurdle before the investigation can get to b). It puts enormous stress on market definition and market share at the expense of a sometimes more appropriate direct attempt to measure the impact on competition. For example, pockets of market power in a differentiated product market may escape, especially if a wider market definition has been previously applied to another merger between less related products in the industry. Alternatively, if one firm already has 51% of the market, it is difficult to say that a merger of any other firms in the industry, even the only two others, will create unilateral dominance. This is especially so because the word ‘dominance’ echoes the terminology of Article 82, which applies to the abuse of dominance by an existing firm or firms. A third example is where a merger results in three equal sized firms, which might result in coordinated effects (‘tacit collusion’).

¹³ The test is not explicitly split into parts a) and b). I have separated a single sentence in the ECMR for the purpose of analytical clarity.

¹⁴ There is also a clarificatory new ‘recital’ proposed for the revised ECMR. See section 6.

This last has received more attention because the doctrine of ‘collective dominance’ has advanced in recent European case law. It is now accepted that dominance need not be by a single firm, but it can be attained by two or more firms together, not necessarily acting in explicit collusion. However, the recent *Airtours* appeal appears to equate collective dominance with a specific model of tacit collusion (i.e. the textbook repeated game model with a transparent punishment strategy). While this model is currently widely accepted to be crucial to understanding the economics of tacit collusion, it cannot be expected to cover all possible instances where market power can be created or strengthened in the absence of single firm dominance. In particular, one reading of the successful appeal is that it excludes a unilateral effects application of collective dominance. Although this interpretation remains untested in the ECJ, in view of the recent court setbacks for DG Comp, it is unlikely that they will risk a controversial case on this issue in the near future.¹⁵

Once again, it is part a) of the DT that causes the problem. It is an unnecessary appendage that just gets in the way of the machinery, and would best be amputated. This would leave a SIEC test, which would prohibit a merger if it was a ‘significant impediment to effective competition’. This has the considerable advantage of building on the current system and case law, without adding to the uncertainty of changing the wording to SLC (which in any case was a 1914 compromise between the US Senate and House of Representatives). In fact, I find the SIEC wording slightly more helpful than SLC, but that is very secondary. The most important point is that there is already a strong consensus as to what merger

¹⁵ This may change if the proposed new Article 2.4 of the ECMR is approved (see section 6). Also, the new merger guidelines seek to address some of the problems outlined above (see Verouden et al, 2003).

regulation should seek to achieve, and the precise wording of SIEC or SLC are consistent with that consensus, whereas some interpretations of the DT are not.¹⁶

4.2 How Efficiencies Should be Incorporated in Merger Appraisal

The substantive test is a lesser source of difference between competition authorities than is the role of efficiencies in merger appraisal. For example, Australia and Canada as well as the UK now have an SLC test for mergers. However, the operation of the test can be very different in each jurisdiction, because of the treatment of expected efficiencies. In this respect, the EU, USA and UK are much closer to each other than they are to Australia and Canada.¹⁷ The former group is ultimately concerned only with consumer benefits of a merger, whereas the latter allow a trade-off of producer benefits against consumer losses.

Many economists favour the position of the latter over the former, arguing that benefits to firms should be weighed against losses to consumers. This is because consumers are individuals who work in and hold shares in firms, possibly indirectly through pension funds, etc. Furthermore, any undesirable income distributions can be dealt with by the tax system, independent of a particular merger decision.

¹⁶ The UK has recently reformed its merger legislation, and the SLC test has replaced the previous 'public interest' test. This applies to mergers which are essentially national and so do not fall within the jurisdiction of DG Comp.

¹⁷ The EU, USA and UK consider efficiencies as relevant only inasmuch as they mean there will be no harm to consumers. In the EU, the Commission is required to take into account 'the development of technical and economic progress *provided that it is to consumers' advantage and does not form an obstacle to competition*' [Art.2.1(b), italics added]. In the USA, 'the Agency considers whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm consumers in the relevant market, e.g., by preventing price increases in that market'. The UK Enterprise Act formally adopts the SLC test with an override clause that mergers are acceptable if they bring relevant consumer benefits (i.e. lower prices, higher quality, greater choice or greater innovation). In contrast, Australia and Canada at least to an extent weigh producer benefits against consumer losses. Australia applies the SLC test except that an authorisation may be granted if it 'would be likely to result in such a benefit to the public that the acquisition should be allowed to take place' (Trade Practices Act 1974, #90.9). This apparent paradox (consumer welfare is all that matters unless the firms appeal for an authorisation to take total welfare into account) can be explained by the fact that an authorisation switches the onus of proof from the competition authority (ACCC) onto the merging firms who must formally apply for an authorisation. It also makes the trade-off explicit and public (and is rarely taken up by firms). Until recently, it was thought that Canada had a full trade-off of consumer and producer welfare, but this appears to have been modified by the Propane case appeal (2001).

However, there is an emerging economic literature that supports a strategic motive for keeping the focus on consumer welfare when appraising mergers. Three such motives have been explored: information advantages of firms; lobbying advantages of firms; and the merger selection advantage of firms. Such advantages create a bias in favour of firms unless the standard by which mergers are appraised is appropriately counter-biased in favour of their customers. Besanko and Spulber (1993) suggest that greater weight should be attached to consumer welfare to counter-balance the asymmetric information advantages of merging firms vis-à-vis the regulator with respect to cost savings that are inevitably exaggerated.¹⁸ Neven and Roller (2000) take into account lobbying by merging firms, and the personal benefits this may bring to regulators; they show that raising the weight on consumer surplus can be an appropriate counter-balance to such lobbying. Lyons (2002) notes that competition authorities are only able to appraise a merger brought before them. They cannot propose mergers. On the other hand, the firms can choose whichever merger they wish, including one that only just satisfies the substantive test. Inasmuch as profits and consumer benefit are negatively correlated at the margin, firms are likely to choose mergers that create negligible total welfare benefit – these would just pass the total welfare standard and maximise profits. While the consumer welfare standard (i.e. allow mergers only if consumers are not harmed) is not necessarily optimal, it is preferable to the total welfare standard, and provides a practical alternative.

¹⁸ Practitioners are well aware of the difficulties of verifying claims which of their essence must be speculative (see the guidance notes published by almost any competition authority). Also, the authorities require that efficiencies between the merging firms cannot be achieved without the merger. This raises some issues addressed in transaction cost economics and incomplete contract theory relating to the efficient boundaries of the firm, and what can and cannot be achieved by market contracts.

4.3 Justifiable Regulatory Action under Ignorance

Economic analysis is not a completed research programme. A glance at the increasing number of academic journals demonstrates the volume of new evidence, ideas and intellectual activity. The history of antitrust in relation to vertical restraints provides an illustration. It has moved from the assumption that non-standard contracts must have a monopoly purpose, to the Chicago view that all such restraints must be benign, to a more sophisticated mixed view whereby the rule of reason is (as far as our current state of knowledge allows) appropriately applied. How do these ideas develop? In part, new theoretical tools facilitate better analysis, but more often than not it is a gut intuition that a current view is misleading that leads a researcher to probe at it and seek for a better analysis. This sort of progress is often stimulated by a particular case that has been controversial. Who knows what progress we will make in our economic analysis over the next decade? Meanwhile, competition authorities must make decisions every day, and sometimes they will find a potential mechanism that does not fit in with the current economic models available. I should make clear that I think it is very rare that a case suggests a completely new mechanism that has not been explored in some form by economists, though it might happen.

The first and most important implication must be that high level economic expertise is necessary to bring to bear the most up-to-date economic theory and empirical methods. Only in exceptional circumstances might a competition authority still be faced with a serious problem: what action is appropriate if no economic models exist to help understand a possibly serious, irreversible anticompetitive mechanism? There is unlikely to be sufficient time during an investigation to commission expert economists to develop new models and debate new mechanisms. Is it sufficient to rely on *ex post* abuse control to reverse the damage if it transpires?

I do not propose even to attempt an answer to this question in this paper but, beyond raising it as an issue, I point to a potential starting point for a debate by listing the criteria applied in another hotly contested area of debate. This comes from a European Commission communication on ‘the precautionary principle’ in relation to health and environmental risks due to chemicals, etc. The precautionary principle suggests a precautionary prohibition (e.g. on antibiotics in animal feed) can be justified as long as it satisfies: proportionality (to the risks if the action were allowed to proceed); non-discrimination (with respect to comparable situations); consistency (with similar cases where full data are available); cost-benefit analysis (of action vs. inaction); subject to review (as and when new evidence becomes available); assignment of responsibility for producing new evidence.

I can foresee huge problems with trying to apply this to merger appraisal and, on balance, I believe that a modified form of the precautionary principle applied to merger review would be a bad idea. In particular, and unlike with human health, it is unlikely that the downside of a low probability event (i.e. a completely new mechanism for potentially exploiting market power) in the context of a merger would be proportional to any potential harm. However, practitioners face daily problems, and if this topic is ignored by economists, it is likely to reduce the influence of good economics. Precise models waiting to be calibrated are not necessary, but anticompetitive mechanisms that have been found to apply in plausible precise models (which might not fit exactly with the current case) are necessary. Bresnahan (2002) makes a similar point in the contentious context of foreclosure and leverage theories: ‘The bedrock principle should not be, in my view, that the right theory of foreclosure to apply to the case should have already been published in the RAND Journal of Economics. Instead, the bedrock principles should be those of rigorous antitrust analysis. What competition will be harmed? How will the merger harm it?’

What evidence [qualitative or quantitative or even anecdotal] shows this specific harm and specific link to the merger??.

5. Some Procedural and Organizational Issues

In this section, I provide a brief international comparison of the administration of competition policy (antitrust), and the procedures used. This builds on the legislation and institutions outlined in section 2, and fills out the backdrop against which the EU reforms can be appraised.

5.1 Merger Guidelines

Guidelines provide an excellent discipline in setting out coherent and consistent practice. It needs to be appreciated that they are at their best when providing safe havens, and not when trying to set out tight analysis more appropriate to an advanced textbook. It also needs to be appreciated that they will often be ignored both by regulators (e.g. the US HHI thresholds appear to be largely ignored in that only cases in substantial excess of them are ever prosecuted) and by the judiciary if they see them to be in conflict with the primary legislation.

There is also a danger of economic fashions getting enshrined when they are past their sell-by date. For example, the HHI was introduced at a time when it was consistent with theories of both unilateral effects and coordinated effects. However, the latter literature has moved on. It is now recognised that symmetric market shares are more likely to facilitate tacit collusion than do asymmetric shares, yet asymmetries give a higher HHI (for a given number of firms). In practice, the HHI is still a very useful indicator, but it no longer has an obvious ascendancy over, for example, a range of concentration ratios.

Nevertheless, it is far better to have guidelines than not to have them, and until very recently they did not exist for DG Comp. Verouden, Bengtsson and Albæk (2003) provide a very useful review of the draft EU guidelines in comparison with the US. Since the new guidelines are still in draft form at the time of writing, it is too soon to judge how they will affect practice.

5.2 Separation of functions

There are several distinct stages in the application of merger policy:

1. Decision to investigate – known as Phase I in Europe, this is an important filter to see whether or not a merger might create a competition concern.
2. Investigation – the full Phase II investigation, which results in a firm opinion about competitive effects.
3. Decision to prohibit or require remedies – how to act to remedy any anticompetitive effects found during the investigation.
4. Appeal – an important discipline to ensure earlier stages are competently conducted.

Different jurisdictions separate these functions differently. In very stylised form, the arrangements are as follows. The length of the arrows is meant stylistically to represent the time between stages:¹⁹

- US = 1 + 2 → 3 -----→ 4
- EU = 1 + 2 + 3 -----→ 4
- UK = 1 → 2 + 3 ---→ 4

¹⁹ Burnside (2002) also summarises procedures in Belgium, France, Germany and Italy. DG Comp is unique amongst these countries in combining the first three stages under a single body.

In the US, the DoJ and FTC (whichever is given responsibility for a particular merger) combine stages 1 and 2, before presenting their case to the court for a preliminary injunction (stage 3). In practice, most cases are settled before going to court, but the immediacy of the courts has a major impact and discipline. A possible negative is that the courts are very evidence based and consequently may over-emphasise the short term at the expense of long-term factors. On the other hand, it is arguable that they accept a lower standard of proof than European courts.

In DG Comp, all three of the main stages are combined. They are conducted by a single team. Also, the appeal system can take years, so has been largely ineffective for mergers. In fairness, an accelerated procedure has been introduced for certain cases, and this was used effectively for the first time in two of the appeals mentioned earlier. However, accelerated appeals are not universally allowed and there can still be substantial delays.²⁰ A problem raised by this institutional set up is that it almost invites an investigation team to get locked into a provisional judgement it had to make during the early weeks of Phase I. Human nature is that we prefer to prove ourselves right rather than wrong, so the temptation must be to spend Phase II trying to justify your own prejudices. The distance of the appeal has, until recently at least, provided only a limited constraint.

The UK system separates the stage 1 initial review (conducted by the Office of Fair Trading, OFT) from the substantive investigation and decision (conducted by the Competition Commission). Of course, this separation means the stage 2 team must start from scratch in trying to understand the case, which is either more time consuming (larger investigation team or longer inquiry period) or sacrifices depth of

²⁰ Even under the expedited procedure, the CFI judgements have taken 12 months after the initial Commission Decisions, which themselves were 5-6 months after original notification of the merger proposals. Few merger proposals are resurrectable after such a period. In the absence of the expedited procedure, the appeal takes much longer. For example, Airtours/First Choice took just under three years from Commission Decision to CFI judgement. The outcome of the GE/Honeywell appeal is expected to take around four years.

knowledge. In the author's admittedly biased opinion,²¹ this is a price well worth paying for a genuinely independent merger review process. The new UK Competition Appeals Tribunal has not yet considered a merger, but it should provide a timely appeals system.

One further issue relates to the timetable for investigations. Both the EU and UK have tight statutory timetables. These can be extended in certain circumstances, and stop-the-clock clauses are available to DG Comp, but these authorities generally stick closely to their timetables. This contrasts with the more elastic US system, which varies much more with the complexity of the case, but which can also drift.

No system is perfect, but it does seem that problems are invited by a system which has neither the immediate shadow of the courts nor the separation of stages 1 and 2.

5.3 Publication

A major advantage of the EU and UK systems is that reasoned (and readable) decisions are published. In the US, far too much remains unpublished and independent reviewers have to rely on a press release and possibly some expert testimony. As any academic knows, written publication is a major discipline for clear thinking, as well as for the dissemination of appropriate analysis.

5.4 Political element

It has already been noted that DG Comp's decisions must be formally ratified by the European Commissioners. Agreement by the Commission is almost invariably a formality in converting a DG Comp recommendation into a decision. Thus, the merger review procedure is largely administrative. Nevertheless, there are two

²¹ The author is a part-time Member of the UK Competition Commission.

potentially significant channels of external influence. First, the Competition Commissioner has weekly meetings with DG Comp staff, at which his views on particular cases can be made clear. Second, other Directorates with sectoral expertise (notably DG Enterprise) are widely consulted throughout the investigation, and can be influential. It is impossible for an outside observer to know exactly how much political pressure is exerted through either of these channels.

Political influence in the US DoJ may be exerted by the process of political appointees, but it is difficult for a transatlantic observer to know how much this matters.

In the UK, until very recently, the Competition Commission (CC) made recommendations to the Minister, who then decided (and occasionally she or he did not act on the CC's advice).²² The Minister could also decide whether to reject the OFT's advice to refer a merger to the CC in the first place. All mergers proposed since June 2003 are under a new regime (established by the Enterprise Act, 2002) which eliminates all political influence – the CC is determinative on nearly all mergers.²³ The decision making process of the CC is interesting in that decisions are made by around four part-time members drawn from business and universities and a full-time chairman, backed up by a strong permanent staff. The normal practice of having at least one Professor of Economics on each panel (known as a 'group') ensures access to high level economic expertise in each merger appraisal. Members of the CC are appointed for four years, extended to eight at their own discretion, and appointments are not renewable. This guarantees independence from political pressures that might otherwise be brought to bear when seeking reappointment.

²² The last of such cases comes up for ministerial decision in January 2004.

²³ In exceptional cases, notably in cases of national security, the Minister may still intervene on the grounds of the public interest.

6. The Reforms

The main reforms are listed at the beginning of section 3. Before proceeding, however, it is important to note the remarkable achievement of the Merger Task Force (MTF) of DG Comp in the last twelve years, during which time it has established itself from nothing to a widely respected competition force. There have been many excellent decisions. This is no mean achievement and it is in this context that the following should be viewed.

6.1 Revised Merger Regulation

There is currently a draft proposal that has been presented as a ‘clarification’ of the Dominance Test.²⁴ The clarification purports to say that dominance in mergers can include collective dominance based on unilateral effects, but that dominance for mergers means something different from dominance in Article 82 cases (abuse of an existing dominant position) – *verstehen Sie?* A cynic might see the new clause as a political compromise to preserve the word ‘dominance’, to which some Member States are overly attached, while eliminating any meaning that might attach to the word.

More precisely, the proposed wording to be inserted immediately prior to the existing test is: ‘For the purpose of this Regulation, one or more undertakings shall be deemed to be in a dominant position if, with or without coordinating, they hold the economic power to influence appreciably and sustainably the parameters of competition, in particular, prices, production, quality of output, distribution or innovation, or appreciably to foreclose competition.’²⁵

²⁴ The draft is being considered by the Council of Ministers and European Parliament. It was expected to come into force in May 2004. However, at the time of writing, the European Parliament was expressing substantial concerns about the proposed revision.

²⁵ Further ‘clarification’ is provided by Recital 20: ‘Irrespective of the structure of the relevant markets affected by a concentration or of the manner in which economic power is manifested or exercised,

In fact, this seems to go much further than a simple clarification of ‘dominance’, and it slips in a fairly fundamental definition of ‘the parameters of competition’. The consultation document (Green Paper), on which this dimension of reform has been based, invited comments on the substantive test. However, discussion of what is meant by competition was fairly tangential to the exercise, and the implications of the proposed wording do not appear to have been worked through. For example, while a constant concern must be to watch out for a merger that might inhibit innovation, it is an incredibly tough test to expect that innovation will be harmed ‘sustainably’. Delay should be problem enough. Similarly, none of the commentary surrounding this clause has made any reference to the interpretation I give in the following paragraph.

More positively, on the face of it, the new clause is a fairly clear statement that competition is to be defined as effects based (as in the US merger guidelines). As such, it may be useful in preventing a potentially damaging interpretation of the existing Article 2(1)(b) of the ECMR that it will immediately follow. Article 2(1)(b) states that a legitimate benefit of a merger is if it encourages ‘the development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition’. The concern (derived from the last seven words) has been that a process, as opposed to effects, based definition of competition might see an efficiency enhancing merger as bad if it would eliminate inefficient rivals, even if that was to the benefit of consumers (i.e. merger policy to protect competitors, not competition). This is further developed in the next subsection.

dominance should be defined in such a way as to reflect a considerable level of economic power held by one or more undertakings’. Recitals are provided at the front of EU legislation as an explanation of the motivation for the legislation that follows. See Verouden et al (2003) for an explanation of this recital by insiders from DG Comp. At the time of writing, there is continuing debate about these ‘clarifications’.

Nevertheless, as far as the substantive test itself is concerned, it would have been far simpler to delete dominance and leave a simple ‘significant impediment to effective competition’ test. The fundamental interpretation of competition could then have been separately highlighted in the new EU merger guidelines.

6.2 Efficiency Defence

Article 2(1)(b) is proposed to be clarified further by a new recital relating to the treatment of merger specific efficiencies. ‘Recital 24: In order to determine the impact of a concentration on competition in the common market, it is appropriate to take account of any substantiated likely efficiencies put forward by the undertakings concerned. It is possible that the efficiencies brought about by the concentration counteract the effects on competition, and in particular the potential harm to consumers, that it might otherwise have and that, as a consequence, the concentration does not create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it. [The Commission should publish guidance on the conditions under which it may take efficiencies into account in the assessment of a concentration.]’

Once again, this is consistent with an effects based merger appraisal using the consumer welfare standard, and it does not confuse the preservation of competition with the preservation of competitors. Since recitals in EU regulations play an important role in interpreting the text, this proposal is helpfully on the right lines.

6.3 Dismemberment of the MTF

During 2003/04, the Merger Task Force will be ‘folded’ into the other, mainly sectoral, antitrust directorates, and its expertise will be spread around.²⁶ These units will deal with mergers alongside Article 81 (agreements between firms) and Article 82 (abuse of a dominant position) cases. Despite appearances, this is not meant to be a punishment for losing a few appeals. The stated aim is to utilise the relative success of the MTF, so that the other units might benefit from the MTF’s discipline in working to tight schedules and other work practices. It also allows a better use of resources given the major swings in merger activity.

I agree that there may indeed be a benefit of spreading expertise into the sectoral units, at the same time as having early access to the detailed sectoral expertise. However, I have two reservations. First, there must be a possibility that good work practices will actually be lost by dilution. Second, and much more important, the reorganisation misses a huge opportunity in that it does not separate Phase I and Phase II investigation teams.

6.4 Devil’s advocate panels

The very modest substitute for separation of case teams is that an *ad hoc* panel now convenes to challenge each team’s analysis before a decision is recommended. This is a good idea up to a point, but it does not (indeed cannot) come early enough. Once a train has left the rails, it is hard to get it back on again. Devil’s advocate panels may prevent gross errors that would be picked up on appeal, but they can be little more than a safety net. Given the strict timetable, they are unlikely to be able to redirect an analysis along more rigorous lines and so run the risk of allowing mergers that in fact require remedy. They are a poor substitute for separation of powers.

²⁶ This will be done in two steps. During 2003, the MTF will continue to exist in a scaled down form, while merger units will be created in all sectoral directorates. In 2004, the rest of the MTF will then disappear (except possibly as a coordinating body).

6.5 Chief economist

An academic economist, Lars-Hendrik Röller, has recently been appointed to advise on specific high profile cases in DG Comp (including state aids), and to provide general guidance at an early stage in enquiries and more widely on economic methodology. The post carries a non-renewable 3-year contract and will be supported by an economics team of ten PhD level economists. This is a very welcome injection of expertise. However, its effectiveness will crucially depend on how well this unit will be integrated into investigations, and at what stage. Modern merger appraisal depends on bringing together law and economics plus detailed industry knowledge. Therefore, real need is for economists, lawyers, accountants and industry specialists to work together as teams right from the start of each case. There is a serious danger of polarisation if a specialist economics unit shouts from a distance, rather than engaging in regular debate from the beginning. It is essential both for morale and influence that a member of the Chief Economist's unit is attached individually and substantively with each significant investigation.

This may be difficult given the resourcing of the unit and the range of investigations in which it will be involved. About 1,200 cases will pass under their collective nose each year, half state aids and the rest shared between mergers and antitrust. The Chief Economist's unit will constitute 11 out of 600 staff. Of course, many cases are essentially trivial and the number of decision-making case staff is much smaller, but the new unit is still small. Realistically, it can only get seriously involved in a small number of high-profile cases. What about the rest?

Perhaps the most attractive vision of the Chief Economist's unit in its role for mergers might be that an individual should be attached as a full case team member from the start of all Phase II cases. This would be a valuable injection of objective

analysis for the inquiry team (which already includes some members with an economics training). In the absence of a completely new Phase II team, however, the success of such a move would depend on the personal qualities of the individual, as much as on their economics expertise. There is a danger that the Chief Economist's unit will be viewed as an arrogant hit squad, and so encounter resistance to their ideas. The distinctive challenge facing the Chief Economist (and his unit) is to respect and influence all members of the investigation teams. This will be as important as his excellent credentials as an academic economist.²⁷

6.6 Merger guidelines

A detailed set of draft guidelines for horizontal mergers has been issued. Guidelines for vertical and conglomerate mergers will follow. Guidelines are good for consistency as well as for encouraging case teams to use appropriate economic analysis. While there is no space to discuss the content of the new guidelines, suffice it to say that in principle they are most welcome. In practice, they also represent a significant statement of transatlantic convergence in economic approaches. Verouden et al (2003) provide a detailed comparison with the US merger guidelines.

6.7 Merger remedies procedure

A significant criticism of the tight timetable for merger appraisal has been that it leaves no time for the merging parties to propose suitable remedies. By the time DG Comp has understood the competitive impact of a merger, there is no time left for the parties to respond. The final reform I have space to mention is provision for an extended timetable in order to determine remedies appropriate to the competition

²⁷ I originally wrote this before Professor Röller's appointment to the post. His personal qualities give me some comfort that this problem might be less serious than I had initially expected.

problem identified. This simple reform seems unambiguously helpful, and has been widely welcomed.

7. Conclusion

I began this paper by asking four questions. Are the reforms in the right direction? Are the reforms sufficient to address all the weaknesses in current procedures? Are they sufficient for DG Comp to move up the competition agency league table? And most importantly, will they improve the economic analysis behind its decisions?

The answer to the first question is a definite yes, but the second must be answered negatively. The most important problem highlighted in this paper is that there continues to be a single case team for all stages of the merger review procedure. All other major jurisdictions either see the need for two or for a court that can act in a timely manner. Other measures, such as the tortuous preservation of the dominance test, are clearly political fudges, patching over the problem without getting to its root. Nevertheless, given the idiosyncrasies in the way the EU works, these patches do not always fall off, and in this case (presuming the drafts get passed into legislation), they may just work. The third question cannot be answered in this paper, because DG Comp has not been alone in its reforms. Fortunately, other countries are also improving so the competition is getting tougher. Finally, I am pleased to say that the most important fourth question can be answered positively. Each of the reforms highlighted in section 6 can be seen as being aimed in exactly this direction. The reform package consistently supports the global trend towards the better application of economics to merger appraisal.

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