Executive MBA
Mergers & Acquisitions

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SIEC-Test

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1. Introduction

With the entry into force of the Council Regulation (EC) No 139/2004 of January 2004 on the control of concentrations between undertakings (hereafter new Merger Regulation) a new substantive test to ascertain, whether mergers are compatible with the common market or not, was introduced into European merger control.

The new appraisal criteria for the assessment of concentrations - the so called SIEC - test, standing for “significant impediment to effective competition” marks a change in merger control from a structural concept protecting the competition as such to an approach, which considers and evaluates effects of concentrations on welfare.

Whereas immediately after the new Merger Regulation was issued, the Commission published Guidelines on the assessment of horizontal Mergers under the new Merger Regulation (hereafter horizontal Guidelines), it took till 28 November 2007 till Guidelines on the assessment of non-horizontal Mergers under the new Merger Regulation (hereafter non-horizontal Guidelines) were rendered. Horizontal and non-horizontal Guidelines are intended to offer general guidance for the assessment of mergers and elaborate the principles developed by the Commission and jurisdiction up to now. As with the publication of the non-horizontal Guidelines guidance for all kind of concentrations is now available, it seems to be an appropriate time to describe the new appraisal criteria for the assessment of mergers.

Subject of the master thesis is only the description of the substantive criteria that is applied in European merger control to assess, if a merger is compatible with the common market and may therefore be implemented. After applying the substantive test the Commission then decides either to block the merger or clear the merger - sometimes with remedies (conditions and obligations) pursuant to Art 8 (2) Merger Regulation offered by the parties. Subject of this master thesis shall solely be an investigation of the criteria for the assessment of mergers under the new Merger Regulation, neither the definition of a concentration, markets, nor procedural issues introduced with the new Merger Regulation nor the question, if European merger control is effective[1] are subject.

The master thesis tries to give economic issues as much space and weight as legal issues as these areas are highly interlinked in the subject matter.

To begin with the fundamental rules and goals of European merger Regulation shall be discussed. As European competition policy, especially merger control, shifted from a structural to a more effects based concept the question, what outcome of the review process should be achieved seemed crucial. The answer to this basic question also has direct impact on the assessment of efficiencies.

In the second chapter economic theory on effects and determinants of mergers shall be summarised. Analysing effects of mergers it seems essential to have at least some knowledge of motives and effects of concentrations. Further such an analysis might under the new Merger Regulation in particular be helpful for the assessment of efficiencies.[2]

In the fourth chapter the old substantive criteria preceding the SIEC-test is described. This is necessary as the new substantive test is largely based on the old material test, all essential concepts of the new test were developed under the old Merger Regulation. An understanding of the new test without the knowledge of the old test would not seem possible.

The fifth chapter is the centrepiece of the master thesis. It describes the SIEC-test and its introduction. As horizontal and non-horizontal Guidelines show the understanding and how the SIEC-test is applied by the Commission in this chapter the Guidelines are summarized and discussed.

The last chapter looks at the substantive test of the national Austrian merger control, which follows a structural approach. The question if in the light of the new European

[1]See *Duso/Gugler/Yurtoglu* working paper 2006.
[2]See *Weizsäcker* (2007) 1082.

appraisal criteria such an approach would even be in accordance with constitutional law shall be asked.

2. Goals of merger control or basic concepts of competition

To begin with – starting from scratch - it shall be looked at the basic principles underlying and determining European Competition law especially from an economic view point. The concepts discussed in this chapter are at the same time a contribution to the analysis of the treatment of efficiencies, as the current understanding under the new merger Regulation of efficiencies directly refers the concepts dealt with in this chapter.

2.1. Legal Framework/Treaty establishing the European Community

In this section the provisions of primary legislation, on which merger control is based on, shall be summarized.

Art 3 g of the Treaty establishing the European Community[3] defines as one of the policies of the Economic Community - pursuing the goals mentioned in EC Art 2 - a system ensuring that *competition* in the internal market is not distorted. In its decision of 21 February 1973 (6/72 "Continental Can") the European Court of Justice (hereafter ECJ) set out that this corresponds to the precept of EC Art 2 whereas one of the tasks of the Community is "..to promote throughout the Community a harmonious development of economic activities…"[4]

Further according to EC Art 2 a balanced and sustainable development of economic activities, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance are listed as economic tasks of the Community.

[3]The consolidated version will be referred to as EC followed by the article reference is made to (eg EC Art 3 g).
[4]Para 24 ff.

In EC Art 81 – 89 implementing the above mentioned policies of EC Art 2 and 3 further specific rules on competition affecting the trade between member states are established.

Art 81 forbids cartels, which are defined (in the wide understanding of the Commission) as all practices, which effect competition within the common market. Such practises may however not be prohibited if they indispensably contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing *consumer a fair share of the resulting benefit* and do not eliminate competition in respect of a substantial part of the products in question (EC Art 81 (3)).

EC Art 82 covers the behaviour of individual firms and seeks to prevent abuses of dominant market positions.

Based on EC Art 83 and 308 the Council issued in 1989 a Regulation on the control of concentrations between undertakings[5] (hereafter old Merger Regulation) recognizing that the effective control of all concentrations in terms of their effect on the structure of competition was necessary.[6]

This development was initiated by decisions of the ECJ, in which the court came to the conclusion that mergers may be prohibited on the basis of EC Art 81 (prohibition of cartels) and EC Art 82 (abuse of a dominant position).[7]

After this short summary of the provisions of European competition law it becomes clear that the regulations concerning competition shall be used to reach the goals mentioned in EC Art 2 and 3. Competition is therefore no value by itself but rather a process to achieve these goals. There may even be higher goals replacing competition.[8] Competition may even have adverse effects and be wasteful for

[5]Council Regulation (EEC) No 4064/89 of December 1989, OJ L 395, 30.12.1989.
[6]See Chapter 3.
[7]Continental Can 6/72 and joined cases 142, 156/84 “Phillip Morris” 17 November 1987.
[8]Eg in the area of agriculture the competition provisions are applicable only to a limited extent. The fact that there may be superior goals also becomes clear regarding EC Art 87 concerning the prohibition of state aid.

economies.[9] Other jurisdictions may have other concepts as for instance german competition law protecting competition as such by the maintenance of a certain market structure.[10] The thought behind this totally different concept maybe that by maintaining the market structure as byproduct pro competitive effects are secured.[11]

2.2. Welfare standards to evaluate mergers

There has been reached wide consensus that especially in the light of these provisions "competition" is not a mere rivalry but a process, the outcome of which is welfare.[12]

This may make the concept a little bit more concrete from an economic point of view, however still leaves the question open, what welfare means, especially whose welfare to consider.

The question is closely linked to the treatment of efficiencies of concentrations. Are economies or efficiencies considered, if they are not passed on to consumers.

In occasional cases, where efficiencies and market power exist *Williamson*[13] posed the question, if economies can be dismissed on the grounds that market power effects invariably dominate?

2.2.1 Consumer welfare standard

Determining the welfare standard the *Commission* makes the following statements.[14]

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[9]See *Heyer* (2006) 21, considering markets, in which incumbent firms are earning significant margins and positive margins will remain even following competitive entry. The costs of entering will be partly covered by revenues on business that the entrant takes away from incumbents. As far as this business can be stolen from the incumbent without a substantial price cut, the benefits of customers may fall short of the associated costs – especially the fixed costs of entry. *Heyer* refers as an example to the numerous high price coffee shops downtown Washington DC.
[10]See *Böge/Jakobi* (2005) 113.
[11]See *Schmidtchen* (2006) 10.
[12]See *Heyer* (2006) 2 or *Böge/Jakobi* (2005) 113.
[13]*Williamson* (1968) 18.
[14]See DG Competition web site: http://europa.eu.int/competition/citizen/index_en.html

"Competition in the marketplace is a simple and efficient means of guaranteeing consumers products and services of excellent quality at competitive prices (…). The best deal for customers emerges as a result of a contest between suppliers."

"Competition policy aims to ensure wider consumer choice, technological innovation and effective price competition, thus contributing to both consumer welfare and to the competitiveness of European industry."

The Commission makes clear that the welfare of consumer is its aim. Mergers are finally evaluated by this standard.[15] If economies are as a result of market power not passed on to consumers, they may not be considered assessing the concentration.

Art 2 (1) of the old[16] and the new *Merger Regulation* list as one (amongst many) objectives of the Merger regulations "….. the development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition."

Consumer advantage is further referred to in recital 29 of the new Merger Regulation[17]:

"...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 would not significantly impede effective competition, in the common market or in a substantial part of it..."

The wording of both the old and the new Merger regulations therefore give no indication that consumers' advantage is a superior objective but rather indicate the opposite.[18] Especially the wording of the recitals suggest that efficiencies may even

[15]But see *Immenga/Körber* in Immenga/Mestmäcker Art 2 para 335.
[16]See below 4. chapter.
[17]The remarks in the recitals however only show the intentions of the legislator and do not constitute binding rules such as the articles of the merger Regulation (see *Immenga/Körber* in Immenga/Mestmäcker Art 2 FKVO para 358).
[18] See also *Immenga/Körber* in Immenga/Mestmäcker Art 2 FKVO Rz 359.

outweigh potential harm of a merger to consumers. This would allow the conclusion efficiencies may not be for the benefit of consumers.

The question is now, if by maximising consumer welfare in merger control the goals of EC Art 2 and 3 are promoted the best way.

Should not mergers be permitted as long as the predicted effect on the total welfare of members of society is positive (so called total welfare standard)

2.2.2 Total welfare standard

Total welfare standard not only considers benefits to consumers but to anybody in society. Any effects increasing welfare regardless, whose benefits are taken into account.

A welfare increase is created through competition. Under perfect competition an economy is working at maximum efficiency and squeezing the highest level of welfare out of its scarce resources.[19]

In perfect competition firms will produce at the lowest possible costs: In perfect competition profits for efficient firms are zero. Any firm that does not produce at the lowest possible costs will leave the market. In such a way *productive efficiency*[20] is reached.

Allocative efficiency[21] is also reached under perfect competition. It occurs when marginal costs of producing one more product is below the amount a consumer is willing to pay for an extra unit. In such a case the producer could sell the product above his costs and below the price that consumers are willing to pay for it. In cases marginal costs are higher then the price consumers are willing to pay for it allocative efficiency is reached through a reduction of output.

2.2.3 Comparing Consumer Welfare to total Welfare Standard

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[19]See *Heyer* (2005), 5. Another group of efficiencies referred to are the so called *innovative efficiency*.
[20]See in detail *Bishop/Walker* (2002) 20.

Efficiencies may appear lowering variable or marginal costs on the one hand[22] or generating savings in fixed costs.[23] Even small percentages in cost savings regardless if fixed or variable or marginal costs may completely offset negative effects of even significant increase in prices and output (as a result of an increase of market power).[24] The figure below ("The Williamson Tradeoff Model[25]") describes such a (marginal) cost saving merger from realization of efficiencies and higher prices from greater market power. The cost savings (area A) offset the negative effects of a significant increase in market power (area B, deadweight loss).

Figure 1:

A =	Increase in Producer Surplus
B =	Deadweight Loss
C =	Transfer from Consumers to Producers
P_1=	Price before the merger
P_2=	Price after the merger
Q_1=	quantity before the merger
Q_2=	quantity after the merger
$Cost_1$=	Average costs before the merger
$Cost_2$=	Average costs after the merger

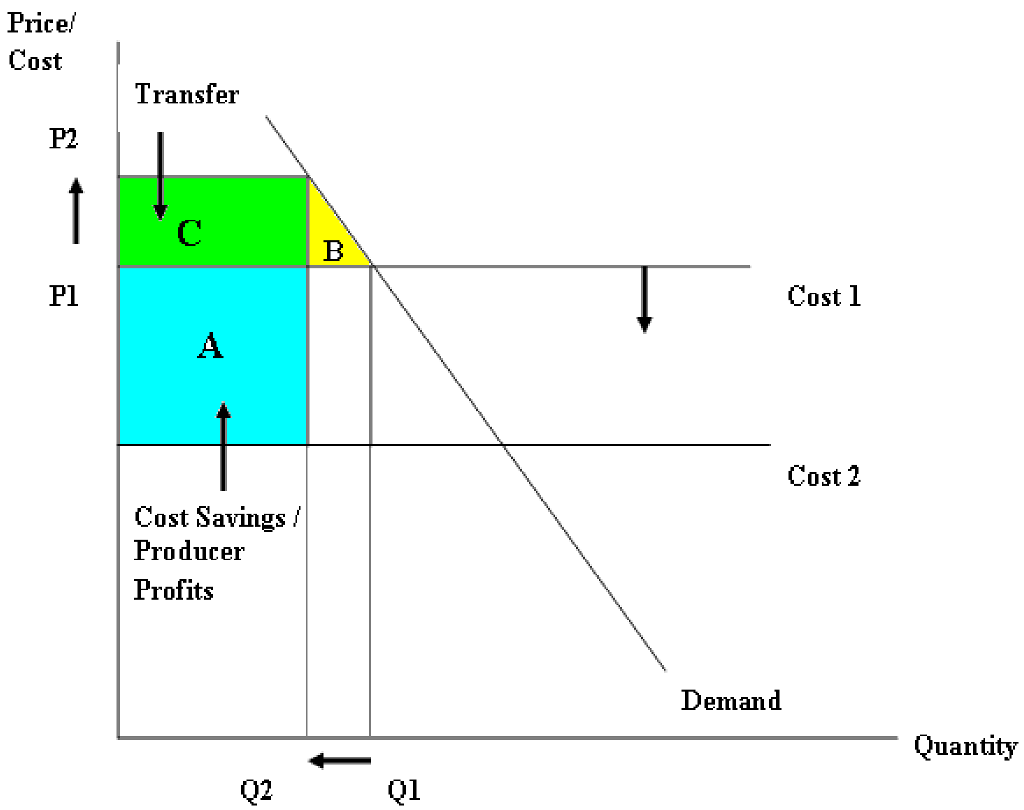
21 See in detail *Bishop/Walker* (2002), 20 et seq.

22 Variable costs are the costs that vary with the level of output. Marginal costs are the costs associated with expanding production or sales at the margin (see horizontal Guidelines para 80 or footnote 106).

23 Besides this mergers can promote the development of new or better products eg by eliminating redundant R & D activities and instead allocate the firms limited assets towards alternative projects (see *Heyer* (2006) 7). *Heyer* argues that such cost savings make innovative activity more likely to occur. This seems questionable as the incentive to achieve innovations may significantly be reduced, if competition is reduced,

24 See *Williamson* (1968) 22 et seq. The "naïve" tradeoff model of Williamson shows for instance the following result: If the elasticity of demand is 2, 4 % cost reduction offset a 20% price increase.

25 See *Williamson* (1968) 21 et seq.



Changes in marginal or variable costs normally lead to lower prices and higher output – even in case of monopolists[26]. There are however cases,[27] in which marginal or variable cost savings may not be passed through to consumers. In such cases, when the producer keeps this savings as rent marginal cost savings would not result in a lower price and therefore under a consumer welfare standard could not be justified, even in cases, when marginal costs savings are higher than the deadweight loss (see Figure 1).

Regarding fixed costs savings such a behaviour is the rule: If fixed costs do not affect the firms viability, they do not alter the firm's profit maximizing price or the level of output, at which profits are maximized, thus fixed cost savings are in contrast to savings of marginal costs usually not passed on to consumers.[28] Fixed cost savings

[26] *Bishop/Walker* (2002) 300 et seq, *Heyer* (2006) 7.
[27] See *Heyer* (2006) 11, *Heyer* refers to cases, in which the merging parties are pure price takers.
[28] *Bishop/Walker* (2002) 301. *Heyer* (2006) 7.

however have major efficiency implications for the entire economy, by freeing up resources for use elsewhere in the economy they increase economies total welfare.[29]

In addition consumer welfare standard and total welfare standard show different results in situations, in which merger created price reductions shift sales to merging parties and away from still more efficient rivals.[30]

The application of consumer welfare standard may create difficult questions, if different consumer groups are affected differently.[31] Which benefits have to be considered and how do they count.

Another question, which arises when comparing consumer and total welfare standard is, if wealth distributional considerations should, when deciding about a merger, be taken into account. Why should consumers be favoured to owners of firms[32]? The owners of publicly listed companies may be normal people – the capital of companies may be life savings of (normal) citizens.[33] Should not distributional issues handled in tax or subsidy programs rather than in antitrust law?

At this point however the strongest argument in favour of a consumer welfare standard can be put forward:

The consumer welfare standard might be a compensation for the asymetric distribution of information and power between consumers and producer. This argument is backed if a low standard of minority shareholder protection in the European community is assumed.

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[29]See *Heyer* (2006) 10 f. *Heyer* describes the case of a competition of firm A and B with differentiated products, in which firm A has unutilized capacity in its factory as a result of a significant and unanticipated drop in demand for firm A's products. If the excess capacity in the hands of firm A could be used to produce the output of firm B the economic benefits in society's total welfare could be substantial (opportunity costs of running the plant of firm B). See also *Schmidtchen* 2006 (14).

[30]*Heyer* (2006), 9 describes an example, where two relatively high-cost firms with small market shares achieve marginal cost savings through a merger and lower prices. This increases the combined sales of the merging firms and may shift sales away from a more efficient rival. In such cases the post- merger output will be produced at a higher total cost.

[31]*Heyer* (2006), 2, refers to the cases, in which impacts of the merger on several markets differ.

[32]See also *Schmidtchen* (2006) 10.

Finally last but not least - in favour of the total welfare standard – it can be argued that total welfare is easier to determine, as it may be difficult to determine the merger specific reduction of marginal costs and to distinguish between efficiencies which are passed on or not.[34]

2.3 Conclusions

The concept of consumer welfare does not seem to be the appropriate standard evaluating (effects of) mergers.

The passage in EC Art 81 (3) permitting *cartels* only, if consumers are allowed a fair share of the benefits, is not sufficient as such to justify the application of a consumer welfare standard in *merger control*.

Merger control as forward-looking assessment of markets has to be distinguished from the regime of EC Art 81 prohibiting competition preventing, distorting and restricting practices:

The Commission and the jurisdiction therefore strictly distinguish between concerted practices within the meaning of EC Art 81 and coordinated effects.[35] While concerted practices are dealt with under EC Art 81, coordinated effects are not subject to the regime of EC Art 81 and may only be taken into consideration when assessing a merger.

Another reason why EC Art 81 (3) cannot be applied as basis for the justification of consumer benefits as precondition of efficiencies in mergers is that the factual situation in cases of cartels differs significantly from merger cases. While in cases of cartels the entire competition in markets and the markets as such are not necessarily affected, in cases of anticompetitive mergers the entire market is affected.[36]

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[33] *Heyer* (2006) 19, refers to the (fictional) case of a merger of all Mercedes Benz repair shops in a geographic market. In such a case the increase in total welfare might shift wealth from rich automobile owners towards service station owners.
[34] *Heyer* (2006), 16.
[35] Horizontal Guidelines para 39 et seq, footnote 55.
[36] See *Immenga/Körber* in Immenga (2007) FKVO Art 2 para 355 and 359.

Neither the new nor the old merger Regulation require the application of a consumer welfare standard. Recital 29 of the new Merger Regulation rather suggests the opposite.

The application of a consumer welfare standard in merger control is therefore not justified, if the goals of EC Art 2 and 3 would be better promoted applying a total welfare standard. Especially in the cases (described above) of fixed cost or marginal cost savings such efficiencies may have to be taken into consideration, even if they are not passed on to customers. On the other hand decreasing prices for consumers may not be taken into account, if a merger only shifts sales from a more efficient rival to the (less efficient) merging parties.

Promoting the goals of EC Art 2 and 3 a mere calculation of the profits and losses of mergers does however not seem to be satisfying. A merger to monopoly (assuming that the monopolist is not restricted by strong potential competition) showing positive effects on total or consumer welfare for example by reducing marginal and fixed costs may not be acceptable. Therefore not every increase of total or consumer welfare may be acceptable, if a competitive market structure is not sustained: From a total welfare point of view it may be wealth enhancing, if R & D activities are reduced through a merger and concentrated at a single firm. Especially this example however shows, that in such a cases the incentive to develop innovations might significantly decrease. Such a decrease of an incentive to research might in the long run be detrimental for an economy. The presences of other independent enterprises in the same markets in an economy ensures the possibility of reflection and comparison for each entrepreneur, which seems to be a basic human need inspiring development, effort and appreciation.[37]

It may therefore in certain cases be necessary to sacrifice "immediate (total or consumer) welfare", if negative effects as a result of a lack of competition in the long run have to be expected.[38]

[37]This phenomenon can be observed in sports. It may not necessarily lead to hostility but can lead to appreciation of others, while the term "rivalry" in this context seems to be the wrong, implying negative behaviour and contempt.
[38]See also *Immenga/Körber* in Immenga/Mestmäcker (2007) FKVO Art 2 para 359.

This leads to the result that competition can be seen as process to enhance total welfare, the application of only consumer welfare could neither be based on the Treaty establishing the European Community nor would it in every case promote the goals of EC Art 2 and 3 the best way. Applying a total welfare standard it however has to be taken into account that a short run positive balance of a merger may not be sufficient as in the long run such a merger may have negative effects for instance preventing further developments by eliminating development and effort in a market.

3. Determinants and effects of mergers

After this look at the basic goals of competition and before turning to the central questions asking which concentrations shall be challenged (or what significant impediment of effective competition shall mean) findings on determinants and effects of mergers shall be considered. This may prepare and give deeper insights and understanding especially in the light of the "more economic approach" in European competition policy answering the central questions posed.

Effects and determinants of mergers are closely linked. Determinants or motives of mergers influence results or effects of mergers. After discussing determinants of mergers, effects of concentrations will be analysed.

3.1. Determinants or motives of Mergers

Mergers are caused by decisions of managers. Firstly managers may be motivated by maximising shareholder value. The aim to maximize shareholder value may be one determinant of mergers. Secondly managers' decisions to merge may not have the goal of maximizing shareholder value but managers may pursue other interests. In the following it will therefore be distinguished between mergers executed for the reason of maximizing shareholder value and mergers implemented for other reasons.[39]

[39] This last group of motives or determinants may explain, why merger waves are corresponding with stock market booms.

3.1.1 Reasonable decisions of managers maximising shareholder value

The cold logic of maximising profits should (under a shareholder value oriented corporate governance system) be the predominant determinant of merger decisions.

A merger may be prompted by the effort to gain *efficiencies*. Efficiencies are for instance economies of scale[40], economies of scope[41], tax carry forwards or network effects[42] or other advantages coming from the merger.[43] They lead to a reduction of costs.

Profit may further be maximised by the increase of *market power*. As a result enterprises may act more independent from competitors and increase prices, reduce output, the choice or quality of goods and services or diminish innovation.[44]

A profit maximizing strategy of mergers would be to acquire *undervalued targets* (economic disturbance hypothesis)**.** Such tender offers were observed in times before the merger wave in the early 1990.[45]

Very similar would be a motive (or determinant) for a merger to gain profits through a turnaround eg replacing the management (so called Market for corporate control theory)[46] or improving the performance of the merged entity through financial efficiencies and the managements' ability to monitor the investment opportunities of each division and shift capital across them (Capital redeployment hypothesis).[47]

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[40]Economies of scale exist, when long run average costs decline as output is increased.

[41]Economies of scope exist, when the total cost of producing two types of outputs together is less than the total cost of producing each type of output separately (eg The production of quantities of steak and chicken dinners is cheaper to produce in the same restaurant than to have two restaurants one that sells chicken and one that sells only steak).

[42]A network effect is a characteristic, that causes a good or a service to have a value to a potential customer, which depends on the number of other customers, who own the good or are users of the service (Eg A telephone network with one user is worthless, a telephone network with two users is more valuable but worth less than a network connecting several users).

[43]Combining of strengths eg: Auto firm A may be better implementing innovative ideas and controlling quality, while auto firm B may be better in marketing and post sale servicing.

[44]See Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings 8.

[45]See *Gugler/Mueller/Yurtoglu* Working paper p 20 Table 5.

[46]Friendly mergers do usually not have this motive, see *Gugler/Mueller/Yurtoglu* Working paper, 20 Table 5.

[47]Conglomerate mergers were en vogue in the 1960s, however the market values of that companies were significantly discounted already in those days. See *Gugler/Mueller/Yurtoglu* Working paper 27.

3.1.2 Reasonable decisions of managers pursuing other goals than maximising shareholder value

Managerial motives pursuing other goals than maximizing shareholder value have predominant impact on decisions to merge.[48] It is these motives that seem to cause mergers which reduce the market power and efficiency of the merging firms.[49]

In *times of stock market booms* it may be reasonable for managers or rather - managers are "tempted" - to undertake mergers for the following reasons:

(i) Managers become overconfident of their ability to manage other companies successfully (hubris), which makes them overbid the target "winners curse".

(ii) If managers know the overvaluation of their company, they may try to rise the real value through a merger influenced by a market, which is gripped with over optimism.

(iii) If managers know the overvaluation, they profit from issuing new shares or from the exchange of shares with a correct valued company ("buying cheap")[50].

(iv) The growth may prevent being taken over and replaced as manager.

(v) The penalty from announcing a bad merger is smaller than in times of no stock market boom, as the market is overoptimistic.[51]

(vi) The over optimism frees the managers hand to use cash flows to finance mergers.

(vii) Increasing cash flows in these times allow the managers to acquire firms for cash without reducing dividends and thus are less likely to lead to share price declines, which would increase the likelihood to become a target of a turnover.[52]

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[48]This reveals agency problems, which are not subject here.
[49]See below 3.2.18 et seq.
[50] This is in fact a shareholder value maximizing motive (see above 3.1.1).
[51]*Gugler/Mueller/Yurtoglu,* Working paper 16.
[52]See *Gugler/Mueller/Yurtoglu,* Working paper 16.

The mentioned “temptations” for mergers are also the reasons, why mergers correlate with stock market booms and lead to losses of shareholders.

3.2 Effects of Mergers

There shall now be listed some scientific observations of effects of mergers helping to get an impression of likely results of concentrations in different constellations:

3.2.1 Mergers can either increase profits by increasing market power (reducing sales, increasing profits)[53] or increase profits by increasing efficiency (such mergers are increasing sales and profits). Mergers may reduce efficiencies and market power (such mergers are reducing sales and profits). Concentrations increasing sales and reducing profits seem to be mergers undertaken by managers, who are growth and not profit maximizes.

3.2.2 Such Mergers, which are not driven by profit maximising objectives (eg empire building goals such as growth) are likely not to increase the market power nor produce efficiencies. Such mergers will destroy values as costs of consummating the merger and integrating the two companies will exceed profits.[54]

3.2.3 In times of stock market booms a coherent strategy of acquiring firms is less likely. As a result the returns of such mergers should be lower than in times of normal or depressed stock value. The same patterns can be observed comparing hostile and friendly takeovers. Hostile Takeovers are more likely to produce positive returns than friendly takeovers, as bidders of tender offers seem to follow more coherent strategies.[55]

3.2.4 If managerial hubris was the motivation for a merger, too high premiums for the target and a loss of returns for shareholders are likely.[56]

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[53] There are several studies proving that market shares are positively related to profitability (see *Mueller* (1985), 259).
[54] See *Gugler/Mueller/Yurtoglu* Working paper 20 or *Gugler/Mueller/Yurtoglu/Zulehner* (2003) 625-653.
[55] See *Gugler/Mueller/Yurtoglu* Working paper 20 et seq.
[56] See *Gugler/Mueller/Yurtoglu* Working paper 20.

3.2.5 In cases of overvalued acquirers or targets capital markets will at some time after the merger find the appropriate value of the acquirer's value. The merger will therefore be followed by losses, however this is of course not a merger specific but general effect.[57]

3.2.6 *Worldwide* on average mergers increase the *profitability* of the merging enterprises. Between 54,8% and 57% of all mergers led to higher actual profits than in benchmark firms from the same industry.[58] This seems to have improved as in the first merger waves studies showed that mergers were likely to lower profitability.[59]

3.2.7 On the other hand *worldwide sales* of the merging parties go down on average after the first post merger year. Only between 44,6% and 49,5% of the merged companies have increased sales after the merger. This negative effect increases through year five post merger.[60]

3.2.8 Worldwide mergers in the manufacturing sector seem to be less profitable than in the service sector. The differences between actual and expected sales are negative in the manufacturing and the service sector. An exception are vertical mergers in the service sector, where in two of five post merger years differences were positive.[61]

3.2.9 Mergers in chemicals and insurance industries have significantly higher profits than in other industries. These profits are accompanied by a decline of sales above average.[62]

3.2.10 Horizontal mergers in manufacturing are significantly more profitable than the average merger in manufacturing (eg vertical or conglomerate mergers). In services industries horizontal, vertical and conglomerate mergers seem equally profitable.[63]

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[57] See *Gugler/Mueller/Yurtoglu* Working paper 20.
[58] *Gugler/Mueller/Yurtoglu/Zulehner* (2003) 636, Table 3A, Profits or *Duso/Gugler/Yurtoglu* Working paper 19.
[59] See *Mueller*(1985), 259 – 267, 259.
[60] *Gugler/Mueller/Yurtoglu/Zulehner*, (2003) 636, Table 3A, Sales.
[61] *Gugler/Mueller/Yurtoglu/Zulehner*, (2003) 641, Table 5.
[62] *Gugler/Mueller/Yurtoglu/Zulehner* (2003) 642.
[63] *Gugler/Mueller/Yurtoglu/Zulehner* (2003) 641, Table 6.

3.2.11 Profitable *cross border mergers* show the same patterns as already described: especially increasing profits and declining sales.[64]

3.2.12 The actual sales of mergers, for which post-merger profitability changes are greater than those of the matching industries, are negative (compared with projected sales) in every post merger year. This seems to be the pattern for mergers that increase market power.[65]

3.2.13 The sales of unprofitable mergers are further below projected values than in cases of more profitable mergers.[66] Such mergers reduced efficiencies.

3.2.14 The mean differences between actual and projected sales for companies undertaking profitable horizontal and conglomerate mergers are negative in all five years following the mergers.[67]

3.2.15 The average unprofitable merger is also (not surprising) an efficiency reducing merger.[68]

3.2.16 Profitable mergers of small firms[69] increase sales by 25%, relative to the average small acquirers size, profits nearly double. This suggests that these mergers increased the efficiencies (creating economies of scale and scope) of the merging firms.

3.2.17 For large firms making profitable mergers actual and projected sales are negative in all five post merger years. In year five after the merger sales on average decrease by about 10,7% of the large acquirers size, while the increase in profits is

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[64] *Gugler/Mueller/Yurtoglu/Zulehner* (2003) 643, Table 7.
[65] *Gugler/Mueller/Yurtoglu/Zulehner* (2003) 644, Table 8, Panel A1.
[66] *Gugler/Mueller/Yurtoglu/Zulehner* (2003) 644, Table 8, Panel A2.
[67] *Gugler/Mueller/Yurtoglu/Zulehner* (2003) 644, Table 8, Panel C, E.
[68] *Gugler/Mueller/Yurtoglu/Zulehner* (2003) 644, 646 Table 8, Panel C, D and E.
[69] *Gugler/Mueller/Yurtoglu/Zulehner* (2003) (646 f Table 9) divided their sample into small and large companies using the median sales of acquiring firm in the first year before the merger as dividing line. Small mergers are defined by them (646 FN 19) to have average sales of $ 341 Mio and profits of 18,1 Mio in the first year after the merger. Large firms have according to this definition average sales of $ 5.713 Mio and profits of $ 264 Mio in year one after the merger. The average deal value of

60,7% of the profits of the average large acquirer. This indicates that the average profitable merger of large firms increases market power.[70]

3.2.18 29,1 % of all mergers are sales and profit increasing and therefore likely to increase efficiencies. 27,6% of all mergers increase profits but decrease sales and should therefore increase market power. 28,2% of all mergers are total desasters reducing sales and profits. 15,1% of mergers reduce profits but increase sales.[71] These results seem to be in line with the findings that acquired firms' tend to loose market shares.[72]

4. The old test ("concept of dominance")

After describing effects and determinants of mergers to get a deeper understanding and broader picture of the subject of merger control, it shall now be looked at the substantive test, which was preceding the current material test with the purpose to process an understanding of the new substantive test, which is based on the old material test.

4.1 Provisions of the old Merger Regulation

Art 2 (1) of the old Merger Regulation stated as general criteria for the assessment of mergers:

"Concentrations within the scope of this Regulation shall be appraised in accordance with the following provisions with a view to establishing whether or not they are compatible with the common market. In making this appraisal, the Commission shall take into account: (a) the need to preserve and develop effective competition within the common market in view of, among other things, the structure of all the markets concerned and the actual or potential competition from undertakings located either within or without the Community; (b) the market position of the undertakings concerned and their economic and financial power, the opportunities available to

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transactions involving large acquirers is $ 667 Mio, while the average deal value involving "small" acquirers is $ 103 Mio.

[70] *Gugler/Mueller/Yurtoglu/Zulehner* (2003) 646 Table 9, Panel A.

[71] *Gugler/Mueller/Yurtoglu/Zulehner* (2003) 650, Table 10.

suppliers and users, their access to supplies or markets, any legal or other barriers to entry, supply and demand trends for intermediate and ultimate consumers and the development of technical and economic progress provided that is to consumers' advantage and does not form an obstacle to competition."

Art 2 (2) and (3) of the old Merger Regulation go on and establish the substantive test. Art 2 (3) of the old Merger Regulation states:

"A concentration 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."

The old test was interpreted in two ways: One version interpreted it as two tier test. A concentration is prohibited if (a) it leads to the creation or strengthening of a dominant position and (b) and if the effect of such a change in market structure significantly impeded effective competition.[73]

Others interpreted Art 2 (2) and (3) of the old Merger Regulation as single criterion arguing that mergers, which create or strengthen dominance automatically also significantly impede effective competition.[74]

The wording of Art 2 (2) and (3) of the old Merger Regulation clearly indicates two tests (or a two tier test), this was also confirmed by CFI in the EDP-decision stating that the old test:[75]

"lays down two cumulative criteria, the first of which relates to the creation or strengthening of a dominant position and the second to the fact that effective competition in the common market will be significantly impeded by the creation or strengthening of such a position [.......] (45) in certain cases, however, the creation or strengthening of a dominant position may in itself have the consequence that

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[72]*Mueller* (1985), 266.
[73]*Röller/de la Mano* (2006) 10 et seq.
[74]*Bishop/Walker* (2002) 258.
[75]T – 87/05 EDP/Commission 21.9.2005 para 45.

competition is significantly impeded (46).[…] It follows that proof of the creation or strengthening of a dominant position within the meaning of Article 2 (3) of the Merger Regulation may in certain cases constitute proof of a significant impediment to effective competition. That observation does not in any way mean that the second criterion is the same in law as the first, but only that it may follow from one and the same factual analysis of a specific market that both criteria are satisfied.(49)"

As both criteria had to be met, a concentration had to be prohibited, if a dominant position was created or strengthened. Coming from the concept of EC Art 82 (abuse of a dominant position)[76] the old Merger Regulation put strong emphasis on the concept of dominance considering market shares, with the exception that the assessment of mergers was more forward looking and concerned less with the current state of competition but rather how the merger affects the markets. The legal definition of dominance was established by ECJ in decision United Brands v Commission[77], where the court stated:

"The dominant position thus referred to (by Article [82]) relates to a position of economic strength enjoyed by an undertaking, which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers."

In practice[78] this meant (and still means) that a market share below 25% are in no case sufficient for a dominant position. Deeper investigations of the Commission could (and still can) be expected if a market position of 40% post merger is reached. Market shares between 25% and 50% may only constitute a dominant position if further aggravating circumstances are found. Market shares above 50% are by itself sufficient evidence for a dominant position.

[76]See above 2.1.
[77]27/76, 14.12.1978, United Brands and United Brands Continental BV v Commission para 63-69.
[78]See *Montag/Jaspers* in Dauses, Handbuch des EU-Wirtschaftsrechtes (2006) § 2 para 79.

The concept of acting independently was criticised as meaningless, no firm even a textbook monopolist can set prices independently from its customers or consumers.[79]

4.2 Economic concepts underlying the old substantive Test

After describing the provisions the old merger control was based on, it shall now be looked at some of the economic concepts, that were used applying the old substantive test. These fundamental basics are developed against the background of a horizontal merger, however are in general also relevant for non horizontal mergers (vertical and conglomerate mergers). At the end of this chapter some specific aspects for the assessment of vertical and conglomerate mergers developed under the old test are presented.

The applied legal definition of dominance was understood by the Commission as what is meant by the economic term of market power.[80] The economic definition of market power consists of three elements:[81]

(i) The exercise of market power leads to lower output.
(ii) The increase in price must lead to an increase in profitability; and
(iii) Market power is exercised relative to the benchmark of the outcome under conditions of effective competition.

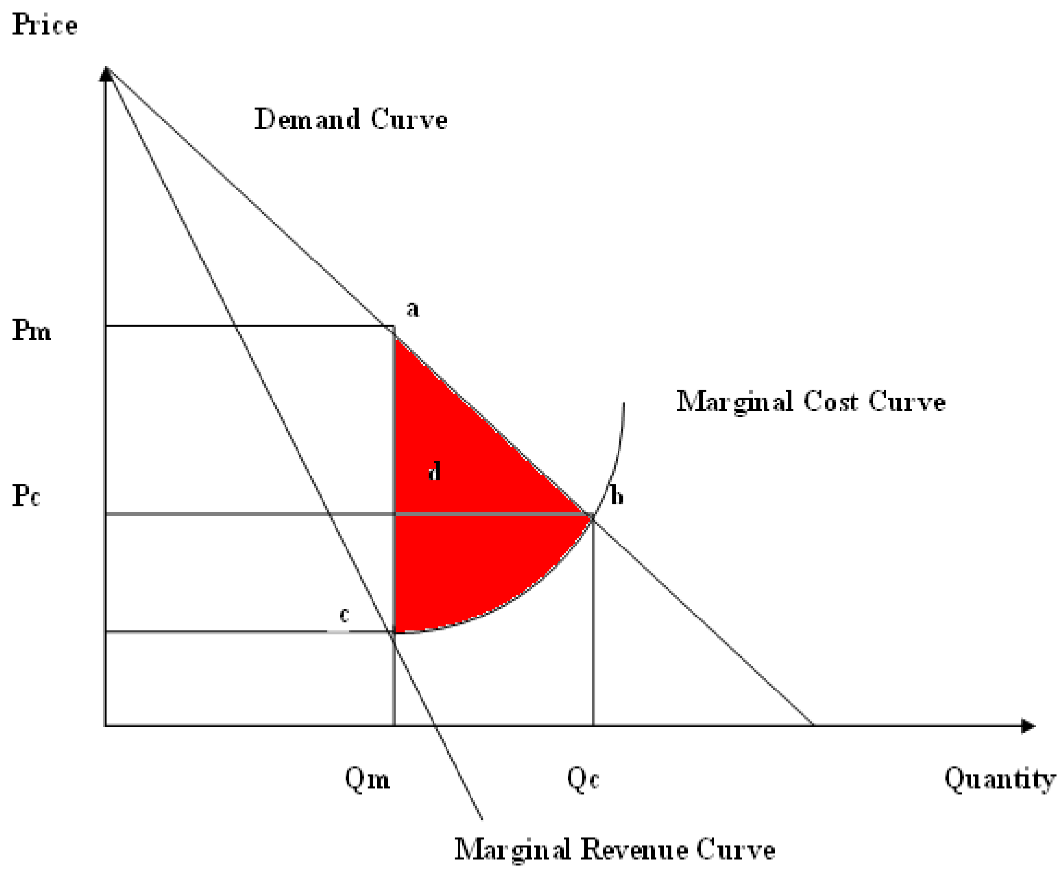
Lower output is usually a result of price increases. If a firm increases prices it must be prepared to sell fewer units:

In industries with perfect competition no economic profits are made, the market price equals to the marginal costs (of the industry), as the seller can make more profit by

[79] *Röller/de la Mano* (2006) 11. This was however not undisputed and led to the introduction of the new substantive test, see below Chapter 5.1.
[80] See *Röller/de la Mano* (2006) 12. In T- 102/96, 25.3.1999 *Gencor v Commission* para 200 the CFI stated regarding the concept of dominance: ”..a situation where one or more undertakings wield economic power which would enable them to prevent effective competition from being maintained in the relevant market by giving them the opportunity to act to a considerable extent independently of their competitors, their customers and, ultimately, of consumers…”
[81] *Bishop/Walker* (2002) 44 ff. Hereafter market power is discussed in terms of pricing power. For the purposes of this scrutiny it can be left open if there is a genuine distinction between pricing and exclusionary power.

selling one more unit at marginal costs.[82] It is not hard to understand that a monopolist will however price above this level. This can be illustrated graphically as follows[83]:

Figure 2



The monopolist will expand (or reduce) his production (and as a result of the higher quantities lower the price) till the marginal revenue of one more unit sold equals marginal costs (Qm). The monopolist will sell less than would be sold under perfect competition (Qc) for a higher price (Pm). The pricing and output decision fails to maximize allocative efficiency. The area *abcd* represents this social welfare loss.

Market power further requires that the price increase leads to an *increase in profitability*. The price increasing firm must benefit from the reduction in quantities as the fall in quantities is outweighed by the higher price. The key question is, how

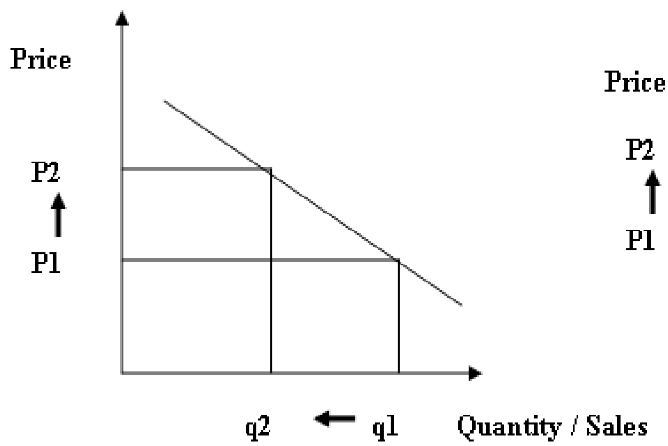
[82]See *Bishop/Walker* (2002) 17.
[83]*Bishop/Walker* (2002) 21.

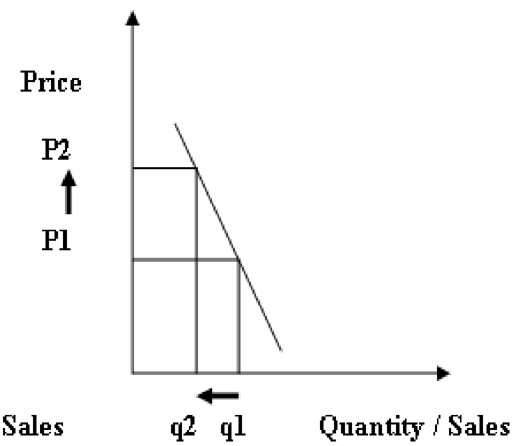
much demand is lost raising the prices. This is measured by the price elasticity of demand facing the firm in the relevant market (*own price elasticity of demand*):

ε (Price Elasticity of Demand) = (Percentage change in sales/quantity)/(Percentage change in price)

The following two graphs show demand curves with different elasticities. While in figure 3 a rise in price from P1 to P2 has a strong effect on sales, in figure 4 a price increase has less effects on quantities, the demand of curve figure 3 is therefore more elastic than that in curve figure 4.

Figure 3 Figure 4





The third criterion defining market power is, if the *increase in prices would persist under conditions of effective competition* (the current price level may not be a correct indication), which obviously is the crucial question that may in practice be difficult to determine.[84]

If firms price at a level that would prevail under conditions of effective competition depends on the elasticity of their (residual) demand curve. A high elasticity indicates that the firm will price at or close to the competitive level. As in merger cases contrary to other cases of competitive assessment the subject is not if current prices are at a competitive level but the development of prices post merger. It is therefore

[84] *Bishop/Walker* (2002) 50 f.

an appropriate measure to consider the elasticity of demand at the current price level to evaluate effects of mergers.[85]

4.2.1 Factors determining market power

The elasticity of demand (and therefore the assessment of market power) depends on several factors. The following factors determining the elasticity of demand of the merging firms were (already) applied under the old Merger regulation by Commission and CFI to evaluate the effects of mergers:

(i) Number of competing suppliers, market shares and concentration[86]
(ii) Potential competition and barriers to entry [87]
(iii) Barriers to expansion[88]
(iv) Product differentiation[89]
(v) The nature of the oligopolistic interaction between firms[90]

4.2.1.1 Number of competing suppliers, market shares and concentration

The *Number of competing suppliers, market shares and concentration* are under the old and the new Merger Regulation the most commonly used proxy for the assessment of a merger. This approach has its roots in the Structure-Conduct-Performance model of competition developed in the 1960, holding that the structure of an industry determines the way, in which firms compete.[91] The more concentrated the market is, the less competitively firms behave. An increasing number of firms in an industry leads to more elastic demand curves as customers have more alternative suppliers to turn to.[92]

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[85] *Bishop/Walker* (2002) 51.
[86] M 1221, 23.10.1999 - *Rewe/Meinl* para 98 – 114.
[87] See M 774, 10.09.1997, *Saint Gobain/Wacker-Chemie*/NOM para 184 - 220.
[88] See T-221/95, *Endemol v Commission* 28.9.1999 para 167 or T-22/97 *Kesko v Commission* 15.12.1999 para 141 et seq. or Commission M 1671, 14.9.2001 *Dow Chemical/Union Carbide* para 107-114.
[89] M 2817, 25.06.2002 – *Barilla/BPS/Kamps* para 34; M 1672 29.5.2001 *Volvo/Scania* para 107 – 131.
[90] T- 102/96, *Gencor v Commission* 25.3.1999 para 277; T-342/99, *Airtours v Commission* 06.06.2002 para 61- 68.
[91] *Bishop/Walker* (2002) 54.
[92] *Bishop/Walker* (2002) 52.

The structure of an industry may however not in every case provide a good indication for competition,[93] for instance if conditions in the market are as such, that it is easy to set up and maintain a cartel. On the other hand, if price competition is very vigorous, then it may be sufficient, if two competitors are there. In bidding markets[94] also firms with low or no market share may affect prices as bids are in general based on costs and the expectations of what others will bid. Such conditions of high competition not reflected in market shares are indicated if market shares were highly variable in the past. Competitors with small market shares may prevent price increases, if barriers to expansion are low.

4.2.1.2 Potential competition and barriers to entry

If entry and exit were very costless and easy even a monopolist might not be able to raise prices. A potential entry (*potential competition*) in a market can prevent firms with very high market shares from exercising market power. An entry decision is determined by the level of unrecoverable costs (*sunk costs*) and the expected profits. High sunk costs and comparatively small markets will make entry less likely. This gives an incentive for incumbent firms to increase the level of sunk costs that potential entrants need to cover entering the market.

But even if costs of entry are low, no firm would consider entering markets, if post entry competition margins were expected so low, that the costs of entry cannot be recovered. For the purposes of assessing mergers such entry barriers (low margins) can of course not lead to competition concerns.

Barriers to entry[95] relevant assessing mergers are set-up costs eg the construction of a plant, advertising or vertical restraints regarding suppliers. Incumbents may increase entry barriers by increasing advertising, switching costs and reducing opportunities for supply (exclusive contracts with suppliers). These strategies reduce an entrant's expectation of future profits.[96] Two types of entry the "hit and run" entry

[93]See *Bishop/Walker* (2002) 54.
[94]Buyers offer a number of firms the chance to be their (preferred) supplier by bidding the lowest price.
[95]An abstract and precise definition of entry barrier has been attempted in literature however shall not be the subject here (see *Bishop/Walker* (2002) 62 et seq).
[96]See *Bishop/Walker* (2002) 66 et seq.

and long term entry can be distinguished.[97] “Hit and run” entry occurs quickly and with no or very low sunk costs. If “hit and run” entry is possible market power of incumbents is usually not high. The more normal situation in markets is the entry that requires significant costs (“long term entry”). Long term entry may still prevent anti-competitive post merger price rises if an entrance is timely, likely and sufficient.[98] The likelihood of entry can be judged looking at the *minimum viable scale*. The minimum viable scale of entry is the amount that the entrant needs to sell at pre-merger prices to break even. If this amount is relatively large compared with the size of the market entry is unlikely.[99]

4.2.1.3 Barriers to expansion

While barriers to entry relate to the ability to impose constraints on the competitive behaviour by firms outside the market, *barriers to expansion* refer to the ability of one firm already in the market to impose constraints to exercise market power on another firm within the market.[100] This is the case, when competitors face decreasing returns to scale. Typical barriers to entry are capacity constraints. Barriers to expansion prevent firms in a market to quickly and cheaply (especially without significant sunk costs) increase output.[101] Neglecting barriers to expansion may lead to the erroneous conclusion that firms with high market shares have market power, if there are high barriers to expansion. Low barriers to expansion by firms already in the market however prevent market power.[102]

4.2.1.4 Product differentiation, unilateral effects

The comprehension of unilateral effects and its treatment under the old Merger Regulation is crucial for the understanding of the reasons for the introduction of the new Merger Regulation and as a result for the new substantive test. Economics of unilateral effects are closely linked with and can be developed explaining what is

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[97]See *Bishop/Walker* (2002) 299.
[98]See *Bishop/Walker* (2002) 299 refering to the US merger guidelines. An entry is considered timely if prices can be affected within two years.
[99]*Bishop/Walker* (2002) 300 refer to the US merger guidelines assuming that a figure substantially above five percent suggests that an entry is not likely.
[100]*Bishop/Walker* (2002) 68.
[101]*Bishop/Walker* (2002) 68.
[102]*Bishop/Walker* (2002) 68, 298.

understood in economics by product differentiation.[103] Thus it shall be tried to describe product differentiation and form that, in a second step, the description of unilateral effects.

4.2.1.5 Product differentiation

The assessment of market power is usually preceded by a definition of the relevant product and geographic markets determining the products that put effective competitive constraints on the prices and terms of the products under investigation.[104] If products are identical (homogeneous) an increase in the price of one firms' products relative to the prices of other firms will result in consumers switching to other suppliers (as all suppliers offer identical products). Albeit in most markets products are not homogeneous, eg there are different makes of cars or jeans.[105]

Product differentiation occurs, where customers have different preferences and tastes. Differences can be created through the production of different qualities (vertical differentiation) or the creation of different customer preferences (horizontal differentiation). Product differentiation reduces price competition in markets. In such cases higher prices than competitors do not necessarily result in a reduction of sales to zero.

Product differentiation makes the (own or residual) demand curve of each firm less elastic.[106] Costly vertical product differentiation may be a way to incur large sunk costs (if consumers are willing to pay for it) and lead to market concentration.[107]

In industries with differentiated products the competitive constraints of firms will vary and some firms will be "closer" competitors than others. If firm A increases prices and as result loses most of its sales to firm B and only a smaller number to

[103]See *Völcker* (2004) 395.
[104]This is mainly done through SSNIP test, focusing on cross price elasticities, however this shall not be subject of this scrutiny.
[105]See the vivid example *Völcker* (2004) 395 et seq.
[106]*Bishop/Walker* (2002) 70.
[107]*Bishop/Walker* (2002) 71.

firm C, A and B are closer competitors.[108] The closeness can be a result of geographic or product characteristics.

Assessing mergers the "closeness" of the products of the merging parties therefore has to be considered. Closeness is commonly captured by *diversion ratios*.[109] The diversion ratio from product A to product B (denoted DAB) is the proportion of sales lost by product A, when the price of product A increases that is captured by product B.[110] To calculate diversion ratios market data on the substitution of products is necessary. If such data are not available diversion ratios are calculated on the basis of market shares. However such an approach cannot consider the closeness of products and is therefore a comparatively poor indicator.[111]

For a merger to result in price increases a significant proportion of customers must regard the products of the merging firms as first or second best choices, if not competing firms are able to reposition themselves and take advantage of price increases.[112]

4.2.1.6 Unilateral Effects

As a result of the above described product differentiation a price increase will not - such as in homogeneous product markets - lead to a loss of all sales. Depending on the closeness of competing products (diversion ratio) only a certain amount of sales will be lost. Taking this into account market players can maximize their profits by raising prices.[113]

The above described price increases may happen even though a dominant position is neither created nor strengthened. These effects are so called *unilateral effects*. Unilateral price increases may also take place following mergers of firms active in

[108]See *Bishop/Walker* (2002) 266 or

[109]An alternative would be a structural demand analysis requiring extensive data, which in many merger cases cannot be obtained for reasonable costs (see *Bishop/Walker* (2002) 267 and 351 et seg (chapter 10)).

[110]See *Bishop/Walker* (2002) 267: Example: The price of product A is increased by 10% percent. As a result sales fall by 1000 units. 400 units are captured by product B (40%). The diversion ratio from A to B (DAB) is 0,4.

[111]See *Bishop/Walker* (2002) 267 et seq.

[112]*Bishop/Walker* (2002) 266 or *Völcker* (2004) 395 et seq.

homogeneous product markets, if competitors face capacity constraints. In such cases – if competing firms are not able add additional production capacity – competitors will not respond to post merger price increases.[114]

Underlying theoretical key concept of unilateral effects analysis are that of the *Nash - non cooperative equilibrium* and the *Cournot model of oligopoly*.

The Nash - non cooperative equilibrium is illustrated in the game known as the *Prisoners' Dilemma*.[115] This can be illustrated by the following figure showing results of strategies of competitors. Each of the boxes represents the results of each firm assuming a certain strategy given the strategy of the other firm. The first number shows the result of firm A, the second number shows the results of firm B. An equilibrium is reached, when no firm wants to change its strategy given the behaviour of all other firms. :

		Firm B	
		High	Low
Firm A	High	9,9	0,18
	Low	18,0	3,3

The equilibrium is reached in bottom right (yellow) quadrant. If one firm chooses a high price strategy the other firm will choose as best response a low price strategy. Best response to low price strategy is for both firms to charge low prices.

A different outcome however is possible if the game is played a number of times. Firms may get the reputation of acting in a cooperative way and reach a high price equilibrium (top left, red quadrant). Such cases are described as coordinated behaviour[116] and have to be distinguished from unilateral effects.

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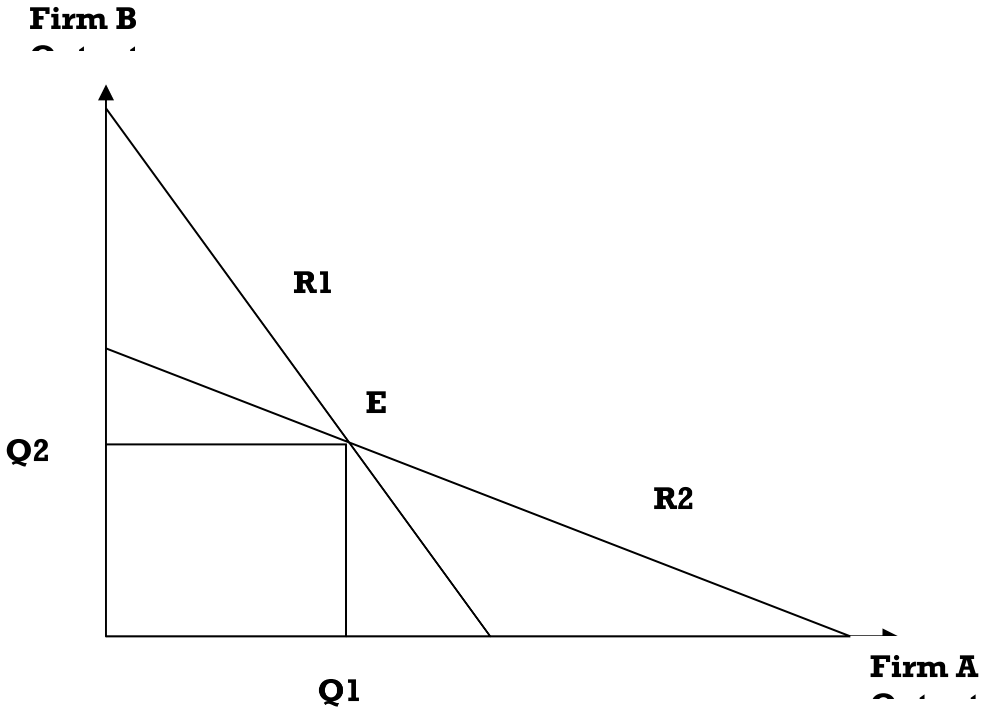
[113]See *Bishop/Walker* (2002) 265 et seq.
[114]*Bishop/Walker* (2002) 270.
[115]See eg *Bishop/Walker* (2002) 28.
[116]See below chapter 4.2.1.5.

Similar to the Nash – non cooperative equilibrium in the *Cournot model of oli*gopoly it is assumed that each firm competes by setting its output so as to maximize profits given the output of the other firm and that firms set their quantities only once.

Graphically this can be shown as follows, assuming that the line R1 describes the maximisied output of firm A for each amount of output produced by firm B and the line R2 the maximised output of firm B for each output of firm A[117]:

Figure 5:



The price of each unit can be determined by the product demand curve and is the price corresponding to the sum of the quantities produced by firm A and firm B. The greater the total output the lower will be the price. The price at the Cournot equilibrium will be lower than under monopoly but less than under perfect competition.[118]

Strictly speaking unilateral effects and dominance analysis are conceptionally different. While dominance analysis is concentrated on the competitors ability to

[117]See *Bishop/Walker* (2002) 30.
[118]*Bishop/Walker* (2002) 30.

compete, unilateral effects are caused by market power, which can be price increases or output reductions by non dominant companies. The Commission relied in its dominance analysis on the concept of unilateral effects although only as an additional consideration to bolster its findings of the structural analysis.[119] This hesitant application of unilateral effects analysis was perhaps a result of the at that time open question if the Commission had the competence under the old Merger regulation to act on the basis of unilateral effects analysis (*oligopoly blindspot*). In a number of cases the Commission argued that the absences of a close competitive relationship of merging parties justified a clearance despite relatively high market shares.[120]

4.2.1.7 Oligopolistic interaction between firms

In addition under the old Merger Regulation *oligopolistic interaction between firms* (*collective dominance*) was recognized as relevant factor assessing market power.[121] In contrast to unilateral effects (such as price increases as a result of larger market shares) co-ordinated effects rely on other competitors.

Besides cooperation explicitly through cartels competing firms may tacitly recognize that vigorous competition is not in their best interest and change in the mode of competition.[122] Firms may change their competitive behaviour understanding that the returns competing less fiercely are higher and thereby raise prices (*co-ordinated effects*).

The concept of such a behaviour may be the above described (4.1.2.4.6) outcome of the *prisoners dilemma*, if players repeatedly face each other.

Co-ordinated effects may - as this indicates - only arise under certain conditions of markets and as rule low price equilibria are more likely than high price equilibria.

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[119]See in Detail *Völcker* (2004) 397 et seq.
[120]See *Völcker* (2004) 400.
[121]M. 190 22.7.1992, *Nestlé/Perrier* para 113; M. 619 24.4.1996, *Gencor/Lonhro* para 179; ECJ C-68/94 and C 30/95 31.3.1998 para 152; M 1524, 22.9.1999, *Airtours/First Choice* para 50, 87et seq. See also *Aigner*, Kollektive Marktbeherrschung im EG-Vertrag – Zugleich eine Untersuchung der Behandlung von Oligopolfällen durch die Kommission und den Gerichtshof der europäischen Gemeinschaften (2001).
[122]See *Bishop/Walker* (2002) 72, 271.

Conditions for a high price equilibriums were seen[123]:

(i) common understanding of profitable terms of coordination;
(ii) ability to detect deviation;
(iii) ability to punish deviation;
(iv) outsiders should not be able to jeopardise the results of coordination.

Assessing concentrations a number of characteristics were considered to indicate the likelihood of tacit coordinated behaviour post-merger:[124]

(i) *Inelastic demand*: If all firms lower prices, demand will not increase much. Thus inelastic demand makes punishment of deviating competitors unlikely as punishment will lead to considerable profit reductions.
(ii) *Transparent markets*: Availability of key information concerning the markets makes it easy to police co-ordination.
(iii) *Homogeneous firms and products*: Firm and product heterogeneity facilitate terms of coordination.
(iv) *Absence of mavericks*: Mavericks in the markets may jeopardise coordination (see conditions for high price equilibria).
(v) *Absence of sophisticated buyer*: Sophisticated buyers or the presence of buyer power puts constraints to competitors.
(vi) *Presence of Excess Capacity*: Available excess capacity gives incentives to raise output and undercut collusive prices.
(vii) *The presence of competitive fringe* tends to limit coordination.
(viii) *Typical transactions in markets:* If transactions are larger and infrequent markets are less transparent than if transactions are small and frequent, coordination is as a result harder to achieve.
(ix) *Low barriers of entry:* Entrants may not participate in collusion. As in cases of too many competitors in a market collusion is therefore impossible.

[123]See eg T-342/99 6.6.2002 Airtours/Commission para 61 et seq.
[124]See *Bishop/Walker* (2002), 274.

4.2.1.8 Countervailing Buyer Power

Coordinated as well as non coordinated effects as above described may be reduced in cases were firms face large, sophisticated buyers.[125] It is although not the size of the buyers per se that triggers such effects but the ability of the buyer to undertake strategies undermining the attempt of suppliers to increase prices.

One strategy of customers may be to switch at least part of their demand to other suppliers. Such a strategy may be very effective, if suppliers profits depend on the level of capacity utilization. Another strategy would be, if buyers sponsor or threat the sponsoring of new entry. This would be the case, if buyers can underwrite the expansion of capacity including greenfield projects even if such projects can only take place with some delay.[126]

4.2.2 Specific aspects of vertical mergers

It seems as if especially regarding vertical and conglomerate mergers the concepts for the assessment of concentrations were largely further developed just under the new Merger regulation.

The foreclosure of rival firms[127] either on downstream or upstream markets are the most important competitive concerns in such cases. Foreclosure may take place by linking different products in different markets.[128] Similar to foreclosure a vertical merger may raise costs of competitors by removing source of supply and as a result to a softening of price competition with price increases as consequence.

Effect of a vertical merger may be the elimination of double marginalisation.[129] This is a pro-competitive effect, which may improve consumer welfare lowering prices.

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[125]M 1225 25.11.1998 *Enso/Stora* para 84 et seq.

[126]*Bishop/Walker* (2002) 297.

[127]See eg M 1693 03.05.2000 *Alcoa/Reynolds* (supplier foreclosure) para 128 or M 2822 – *ENBW/ENI/*GVS 17.12.2002 para 54-57 (customer foreclosure).

[128]"Bundling" and "tying" see below 4.2.3.

[129]Whenever there is market power on both competitve levels two mark ups will be imposed. See *Bishop/Walker* (2002) 156.

The Commission however assumed in such cases under the old Merger Regulation that competitors would be unable to compete, driven from the market and as a result the vertically integrated firm was expected to be able to raise prices (*efficiency offense*).[130]

A strong non coordinated anti-competitive effect was considered to arise from access to sensitive information concerning the upstream or downstream activities of competitors,[131] for instance, becoming a supplier of a downstream competitor a firm may obtain information, that allows to price less aggressively.[132]

Vertical integration was also considered to facilitate coordinated effects either on upstream or on downstream markets.[133] Destabilising outsiders (mavericks) may be reduced through vertical mergers. Upstream or downstream coordination may be made easier through the reduction of the players or an increase of transparency (eg: coordination concerning retail prices will be easier than regarding wholesale prices).[134]

4.2.3 Specific aspects of conglomerate mergers

Conglomerate mergers are mergers between enterprises, that are neither in a horizontal (as competitors) nor in a vertical (supplier or customer) relationship. Whereas such mergers (with no horizontal overlap) were often considered not problematic, it has already been shown that also such mergers may have anticompetitive effects just like horizontal mergers reducing quantities.[135]

The Commission considered that complementary market positions in different product markets will give the merging entity a competitive advantage (*range effects*

[130]See M 130 13.09.1991 Delta/Airlines/PAN AM para 21. For a description of decisions arguing with an *efficiency offense* see *Böge/Jakobi* (2005) 115.
[131]M 1879 29.10.2000, *Boeing/Hughes* para 82.
[132]M 2822 17.12.2002, *ENBW/ENI/GVS* para 56 et seq.
[133]M 3101, 16.05.2003 *Accor/Hilton/Six* para 22-28.
[134]See above 4.2.1.5
[135]See above 3.2.14

or *portfolio power*).[136] Underlying thought is that the market power resulting from a range of products in separate markets is larger than the sum of its parts.[137]

Another concern raised in conglomerate and vertical mergers was foreclosure. This can be achieved by leveraging a strong market position from one market to another as a result of tying or bundling.[138] *Bundling* refer to practices linking different products in different markets together, for instance, if products are only sold jointly or if the sum of the stand alone prices is lower than the bundled price. *Tying* means that customers that purchase one good are required to purchase another good from the producer either for technical or legal reasons.

The negative effect of leveraging is usually not expected in the short run, in which prices for the bundled or tied products are expected to decrease. In such cases negative competitive effects were assumed, when competitors are as a result forced to exit markets (*efficiency offense*).[139]

4.2.4 Defences

In certain cases the Commission saw despite anti-competitive effects of a concentration legitimate grounds for permitting the merger. Defences justifying such concentrations were considered the failing firm defence and the efficiency defence.

4.2.4.1 Failing firm defence

Although there is no explicit provision providing for cases involving failing firms the Commission and ECJ have developed a defence allowing mergers in cases of loss making firms.[140]

[136]Eg M 794 22.01.1997 *Coca Cola/Amalgamated Beverages* para 208, M 2220, 03.07.2001 *GE/Honeywell* eg para 276, 293, 398.
[137]*Bishop/Walker* (2002) 291 with doubts.
[138]See eg M 2416 30.10.2001 *Tetra Laval/Sidel* para 327 et seq.
[139]*Bishop/Walker* (2002) 293. For a description of decisions arguing with an *efficiency offense* see *Böge/Jakobi* (2005) 115.
[140]ECJ 31.3.1998 C 68/94 and C 30/95 *Kali und Salz* para 110 et seq.

Problematic mergers involving failing firms are compatible with the common market, if the market would deteriorate to at least the same extent in the case of the exit of the failing firm.

Three criteria for the failing firm defence were/are:

(i) The acquired undertaking would be forced out of the market if not taken over.
(ii) There was no less anti-competitive alternative purchaser, and
(iii) The acquiring undertaking would have taken over the entire market share of the acquired undertaking, if it had been forced out of the market.

4.2.4.2 The efficiency defence

It was shown in chapter 3.2. that a large fraction of mergers show efficiencies, as such concentration are leading to a higher profitability and sales. As described in chapter 2 such efficiencies may be a reduction of marginal or variable costs or fixed costs.

Legal basis for the consideration of efficiencies was seen in Art 2 of the old Merger Regulation referring to "….the Commission shall take into account: (a) ….. and the development of *technical and economic progress* provided that is to consumers' advantage and does not form an obstacle to competition."

However the Commission has under the old Merger Regulation adopted a hostile stance towards claimed efficiency benefits of mergers arguing, that they may not be taken into account, if a dominant position was created or strengthened.[141] Thought behind this reasoning obviously was, that with the merger the constraint to pass efficiencies on, is lost.[142]

[141] M 1313, 9.3.1999 „*Danish CrownVestjyske Slagterier*" para 198.
[142] *Immenga/Körber* in Immenga/Mestmäcker FKVO Art 2 para 373.

As a result under the old test efficiencies could - in practice - not counteract competition concerns. Efficiencies were often seen from the competitors point of view and the damage they may do to less efficient firms (*efficiency offense*)[143].

5. The new Test

On 27 November 2003 the Council adopted with the necessary unanimous vote a new Merger Regulation and replaced as of 1 May 2004 the old Merger Regulation, which was in force since 1990 for a period of 13 years. Besides procedural issues the main content was a new substantive test to ascertain, whether mergers are compatible with the common market or not.

After looking at the reasons for the introduction of the new test, the new test shall be examined. The assessment can be based on the findings and explanations regarding the old substantive test,[144] as the new test is a development of the old test.[145] At the end of this chapter the Guidelines on the assessment of horizontal as well as the Guidelines on the assessment of non-horizontal mergers are described as they reflect the understanding of the Commission of the new test.

5.1. Reasons for the introduction of the new test

Reform efforts of the old Merger Regulation were started, when the Commission launched a Green Paper at 11 December 2001 (hereafter Green Paper).[146] These efforts were given impetus, when in 2002 the CFI annulled a number of Commission decisions making clear that the economic reasoning of the decisions was not satisfactory.[147]

The Green Paper considered - the Commission did however not recommend it – the adoption of the substantive lessening of competition test (hereafter SLC – test)

[143]For a description of decisions arguing with an *efficiency offense* see *Böge/Jakobi* (2005) 115.
[144]See chapter 4.
[145]See new Merger Regulation Introduction para 26 or *Baxter/Dethmers* (2005) 381.
[146]Commission Green Paper on the Review of Council Reg. 4064/89 COM 2001 745/6 final. Available at http://europa.eu.int/eurlex/en//com/gpr/2001/com2001_0745en01.pdf.
[147]T-342/99, 6.6.2002, *Airtours v Commission*; T 310/01, 22.10.2002, *Schneider Electric v Commission*; T 5/02, 25.10.2002, *Tetra Laval v Commission*.

already used in other jurisdictions such as the US, United Kingdom, Australia, Canada, Japan and Ireland.[148]

This would allow an alignment of the Merger Regulations' appraisal criteria applied in other major jurisdictions such as US, Canada, Japan and Australia and prevent contradicting decisions of competition authorities assessing mergers of a global scope (*global standard of merger control*).

Further there was uncertainty, if the Commission had legal basis to prohibit mergers with unilateral anti-competitive effects below the level of single dominance (*oligopoly blindspot*):[149] As already mentioned above (chapter 4.2.1.4 et seq) the concept of single firm dominance can be distinguished from unilateral effects analysis: While the single firm dominance was based on the monopoly model, the unilateral effects theory is based on game theory and the oligopoly model. Dominance analysis is concentrated on the competitors' ability to compete, unilateral effects on the other hand are caused by post merger market power of certain competitors. The Commission considered a problematic constellation to examine, the merger of the second and the third largest firm in a homogeneous product market, if the merged enterprise remains smaller than the largest firm in the market and there is no evidence of co-ordination.[150] In such cases a dominant position may neither be strengthened nor created and thus a prohibition on the grounds of the old test might have been questionable, if unilateral effects analysis was from a legal point of view not part of the appraisal criteria.

Under the old test it was further asked, if there was a legal basis for the consideration of efficiencies of a merger.[151] As shown above (chapter 4.2.4.2) in practice efficiencies did not play a role. The less legally rigid SLC test was seen to facilitate efficiency considerations.

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[148]Green Paper para 160 et seq.
[149]See *Baxter/Dethmers*, (2005) 380 et seq; *Maudhuit/Soames* (2005) 75 et seq or *Völcker* (2004) 401.
[150]See Green Paper para 166. For further such alleged blindspot cases see *Bishop/Walker* (2002) 309.
[151]*Rosenthal/Pate/Shores* (2007) 31, *Bechter/Klement* (2004) 356.

Especially UK and Ireland favoured the SLC-test, while Germany, Italy, Austria and Luxemburg insisted on the old test.[152] In January 2003 the Commission published a draft of a new merger regulation keeping the old test - only clarifying, that it had competence to prohibit mergers with unilateral anti-competitive effects below the level of single dominance (oligopoly blindspot).[153] The draft was however not accepted in the Council. As there was no majority for the SLC – test and no majority to continue with the appraisal criteria of the old test, a compromise had to be found.[154] A number of proposals for hybrid tests were then rejected.[155] In the course of this process the Commission repeatedly stressed the fact, that main reason for the introduction of a new test was to achieve a higher degree of legal certainty and that the question, which test to apply, was largely an academic debate anyway.[156]

Finally (in the last minute) a compromise was found and the new Merger Regulation could enter into force on 1 May 2004.

5.2 The SIEC-Test

Instead of the SLC-test the Council agreed on a SIEC-test[157], standing for "significant impediment to effective competition". The compromise consisted in the elevation of the second criterion of Art 2 of the old Merger Regulation to the sole decisive criterion, while the creation and strengthening of a dominant position was reduced to a (non exhaustive) prime example.

The factors, that have to be taken into consideration applying the test, mentioned in Art 2 (1) including especially the passage "the development and progress provided that it is to the consumers' advantage and does not form an obstacle to competition..", which were regarded as the basis for a possible consideration of efficiencies, were not changed.

[152]See *Böge*, Reform der Europäischen Fusionskontrolle, WuW 2004, 139.
[153]MünchKommEuWettbR *Röller/Strohm* Einl 1542 or *Völcker* (2004) 402.
[154]MünchKommEuWettbR *Röller/Strohm* Einl 1546.
[155]See in detail MünchKommEuWettbR *Röller/Strohm* Einl 1548.
[156]See *Völcker* (2004) 402.
[157]Also sometimes abbreviated as SIC-test (eg *Voigt/Schmidt* Switching to Substantial Impediments of Competition (SIC) can have Substantial Costs – SIC ECLR [2004] 584 et seq or *Voigt/Schmidt* The Commission's guidelines on horizontal mergers: Improvement or Deterioration? Common Market Law Review (2004) 1583 et seq.

A comparison of the wording of the old and new substantive test illustrates the change:

Art 2 (2) and (3) Old merger Regulation	Art 2 (2) and 3 new Merger Regulation
"..(2) A concentration which 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 shall be declared compatible with the common market. (3) A concentration 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. .."	"..(2) A concentration which would not significantly impede effective competition in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared compatible with the common market. (3) A concentration which would significantly impede effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared incompatible with the common market. .."

The recitals 25 and 26 of the new Merger Regulation explain the change as follows:

"(25) ... Many oligopolistic markets exhibit a healthy degree of competition. However, under certain circumstances, concentrations involving the elimination of important competitive constraints that the merging parties had exerted upon each other, as well as a reduction of competitive pressure on the remaining competitors, may, even in the absence of a likelihood of coordination between the members of the oligopoly, result in a significant impediment to effective competition. The Community courts have, however, not to date expressly interpreted Regulation (EEC) No 4064/89 as requiring concentrations giving rise to such non-coordinated effects to be declared incompatible with the common market. Therefore, in the interests of legal certainty, it should be made clear that this Regulation permits effective control of all such concentrations by providing that any concentration which would significantly impede effective competition, in the common market or in a substantial part of it, should be declared incompatible with the common market. The notion of "significant impediment to effective competition" in Article 2(2) and (3) should be interpreted as extending, beyond the concept of dominance, only to the anti-competitive effects of a concentration resulting from the non-coordinated behaviour of undertakings which would not have a dominant position on the market concerned.

(26) A significant impediment to effective competition generally results from the creation or strengthening of a dominant position. With a view to preserving the guidance that may be drawn from past judgments of the European courts and Commission decisions pursuant to Regulation (EEC) No 4064/89, while at the same time maintaining consistency with the standards of competitive harm which have been applied by the Commission and the Community courts regarding the compatibility of a concentration with the common market, this Regulation should accordingly establish the principle that a concentration with a Community dimension which would significantly impede effective competition, in the common market or in a substantial part thereof, in particular as a result of the creation or strengthening of a dominant position, is to be declared incompatible with the common market."

Solely from these passages the following conclusions can be drawn:

The SIEC – criteria give more discretion to the Commission as the wording (arg: "significant" "impediment" "effective") is more indefinite than the old criteria. Regarding this it was emphasized in recital 26 that the old Commission decisions and court judgements still provide guidance as the creation or strengthening of a dominant position was still considered the main example of the appraisal criteria. In recital 25 the legislator even states that the concept of dominance shall only be extended with respect to the anti-competitive effects of a concentration resulting from the non-coordinated behavior of undertakings, which would not have a dominant position on the market concerned. The extension beyond the concept of the old Merger Regulation should therefore if that was necessary – “only” concern the alleged *oligopoly blindspot*.[158] With the entry into force of the new Merger Regulation the Commission published the horizontal Guidelines - binding its practice.

It has to be recorded at this point that legal certainty was as well for the legislator as the Commission a decisive motive issuing the new merger regulation. Enterprises should be able to know before starting the costly process of a concentration, if the intended concentration can be cleared.[159]

It also becomes clear that the concept of dominance as such was not changed. Therefore mergers with market shares below 25% will not be problematic and even - as in recital 32 of the new Merger Regulation stated - not raise concerns regarding a significant impediment to effective competition.

With the explicit extension of the substantive test on unilateral effects analysis as described above the legislator not only prevented underenforcement in cases of mergers between the second and the third largest firms, where there is no creation or strengthening of a dominant position. It was also made sure that in other cases, when the price equilibrium changes, the merger can be prohibited[160]:

(i) Takeover of a potential entrant exercising constraint on all members of an oligopoly by an encumbent firm (Elimination of potential competition).
(ii) Acquisition of a non dominant firm over a small innovative rival to prevent or delay the introduction of a new product (Control of entry barriers).

[158]See above Chapter 4.2.1.4 and 5.1.
[159]Which is obviously a very ambitious goal.
[160]See *Röller/de la Mano* (2006) 18 et seq.

(iii) Merger between an upstream and a downstream firm, when the upstream firm has after the merger less incentive to engage in price cutting to serve downstream firms. The rival upstream firms may charge higher prices (Raising rivals' costs).

(iv) Another constellation raising rivals' costs is, when a monopoly integrates downstream. The monopoly may then have the incentive to raise the downstream price level.

(v) Mergers in up - or downstream markets reducing countervailing buyer power (eg spin off of a firm that exercises countervailing buyer power) may also lead to a higher equilibrium price.

(vi) Mergers in network markets, which shift the market to a standard favouring incumbents, may reduce the likelihood of entry and lead to a higher equilibrium price.

(vii) Mergers allowing the joint control of an essential facility and therefore price increases downstream (compare above iv).

The wider discretion of the Commission enables the Commission to extent its already under the old Merger Regulation developed effects based analysis and to facilitate the clearance of pro competitive mergers, which could not have been allowed based on a dominance test:[161]

(i) most prominent example are *efficiencies* of a merger counteracting potential harm to consumers (see below chapter 5.3.1.9);

(ii) the Commission may find it easier to authorise mergers involving firms with highly differentiated products even if the merged entity has the largest market share[162];

(iii) the creation of countervailing buyer power may reduce upstream dominance or collusion and reduce constraint on input purchasers[163];

(iv) the Commission may find it easier to clear mergers, which only have a *de minimis* impact (eg small markets);

[161]See *Röller/de la Mano* (2006) 20 et seq.
[162]See *Völcker* (2004) 400.
[163]It is questionable and of course not very satisfying to reduce the negative effects of concentration with even more concentration.

(v) a merger, where single dominance replaces collective dominance may so disrupt the market as to render further coordination impossible;

It is undisputed amongst scholars that the new test did not bring a radical change. [164] A clear "gap case", a case which would have been decided differently under the old Merger Regulation, has not been detected.[165] However *Siemens/VA Tech*[166] seems to be a gap case:

In this decision the Commission left the structural approach assessing mergers and was not relying on dominance. In the markets of mechanical metal plant building acquiring Siemens was not active in but held a minority shareholding in a main competitor (SMS) of VA Tech (the target). In the opinion of the Commission the minority shareholding in SMS would enable VA Tech to anticipate SMS competitive behaviour and therefore have a harmful impact on competition as a result of uncoordinated behaviour by firms.[167] In several power transmission and distribution markets, especially the market of high voltage turnkey projects, markets shares, showing an increase of a dominant position were assessed[168] however as the markets were considered project driven and as the merging parties were not seen as close competitors a significant impediment to effective competition was not assumed.[169] The Siemens/VA Tech case can therefore be seen as a so called "Gap Case", a case which would have been decided differently under the old merger regulation.[170]

5.3. The guidelines on the assessment of Mergers

Together with the introduction of the new Merger Regulation with a view to the required legal certainty the Commission issued guidelines on the assessment of horizontal mergers. On 28 November 2007 the Commission published guidelines on the assessment of non horizontal mergers under the new Merger Regulation

[164] See *Immenga/Körber* in Immenga/Mestmäcker Art 2 para 184. *Böge*, Reform der Europäischen Fusionskontrolle WuW 2004 138, 143 et seq or *Staebe*, Die neue Europäische Fusionskontrollverordnung (VO 139/2004) EWS 2004, 194, 195; *Völcker* (2004) 395. *Röller/ de La Mano* (2006) 23 et seq.

[165]

[166] M 3.653 13.07.2005.

[167] M. 3.653, Siemens/VA Tech 13.07.2005 para 335.

[168] M. 3.653, Siemens/VA Tech 13.07.2005 para 83.

[169] M. 3.653, Siemens/VA Tech 13.07.2005 para 89 -101.

(hereafter non-horizontal Guidelines). Aim of both guidelines is to draw and elaborate the above (see chapter 4) described principles developed under the old Merger Regulation.[171] The Commission is bound by notices, which it issues in the area of supervision of concentrations, if they do not depart from the rules in the Treaty and from the Merger Regulation.[172] These guidelines shall now be discussed with a view to the new substantive test and the principles developed under the old Merger Regulation.

The horizontal guidelines are intended to offer general guidance for all (horizontal and non-horizontal) mergers.[173] The non-horizontal Guidelines are deemed to concentrate only on competition aspects relevant to the specific context of non-horizontal mergers.[174] Horizontal Guidelines shall therefore be discussed before the attention is turned to the non-horizontal guidelines.

Mergers may entail both horizontal and non horizontal effects. In such cases the Commission will appraise horizontal, vertical and/or conglomerate effects in accordance with the guidance set out in the relevant notices.[175]

5.3.1 Horizontal Guidelines

5.3.1.1 Market shares and concentration levels

Market shares and concentration levels shall still serve as first indications for the assessment of a merger.[176] Normally the Commission will use current market shares calculating post merger market shares on the assumption that the combined post merger market shares are the sum of pre-merger market shares.[177] However the Commission will in its assessment reflect historic data, if market shares have been

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[170]See *Röller/de la Mano* (2006) 24.
[171]See recital 6 of the horizontal guidelines and recital 8 of the non horizontal guidelines.
[172]See for instance T-282/06 9.7.2007 Sun/Commission.
[173]Non-horizontal Guidelines para 6.
[174]Non-horizontal Guidelines para 6.
[175]Non-horizontal Guidelines para 8.
[176]Horizontal Guidelines para 15 and 31. In bidding markets the Commission considers market shares as no good indicator of the intensity of competition (see eg M. 3653 13.7.2005, *Siemens/VA Tech* para 39 or 93).
[177]Horizontal Guidelines para 15. In cases of anti-competitive mergers however post merger market shares are reduced and are not equal to the sum of premerger market shares (see above Chapter 3.2).

volatile also reasonable future changes (expected exit or entry) are taken into account.

The considerations in the non-horizontal Guidelines regarding market share levels are kept very vague and it seems that the Commission assumes now a wider leeway in this area.[178] In Paragraph 17 the Commission starts saying that market shares above 50% may be sufficient evidence for the existence of a dominant position and goes on to say that also shares between 40 and 50% can mean dominance, it then concludes that even market shares below 40% can establish a dominant position.[179] However in para 18 it seems, that the lowest threshold for market shares establishing a dominant position is defined with a market share of 25%.

In addition to market shares the Commission introduces a second tool, the Herfindahl-Hirschmann Index (hereafter HHI), to assess post-merger market concentration.[180] This indicator has already been used by the Commission and has been applied in US merger policy for a long time. The HHI is calculated by summing up the squares of the individual market shares of all firms in the market.[181] It gives therefore greater numbers to higher concentrated markets. While the absolute number is giving an initial indication of the competitive pressure (reflecting a dominance approach) the change HHI (hereafter Delta) is used as a proxy for the changes in the markets caused by the merger (reflecting an effects based approach). The Delta can be calculated doubling the product of the market shares of the merging firms.[182]

The Commission now considers three thresholds[183]:

(i) the post-merger HHI remains below 1000. Such markets are considered to normally not require extensive analysis.

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[178]*Maudhuit/Soames* (2005) 78 consider in the light of the explanations in para 17 a lowering of the thresholds.

[179]See *Voigt/Schmidt* The Commission's guidelines on horizontal Mergers: Improvement or Deterioration, Common Market Law Review (2004) 1583, 1588 critizising this lack of predictability.

[180]Horizontal Guidelines para 16.

[181]For instance: a market consisting of three firms with market shares of: 10%, 50% and 40% has an HHI of 4200 ($10^2+40^2+50^2$).

[182]See Footnote 19 of the Horizontal Guidelines. Before the Merger the market shares of the merging firms were the sum of their squares (a^2+b^2). After the merger the market share of the new firm is the sum of the market shares squared $(a+b)^2$, which equals $a^2+2ab+b^2$. The difference between pre and post merger is therefore 2ab ($a^2+2ab+b^2-a^2-b^2$).

(ii) The post-merger HHI remains between 1000 and 2000 and a Delta below 250. Also in such cases it is unlikely that the Commission will identify horizontal competition concerns.

(iii) The post-merger HHI is above 2000 but the Delta is less than 150. Such concentrations are not regarded problematic, if there are no special circumstances, such as the involvement of a potential or recent entrant, one of the merging parties is an important innovator or a maverick firm, there are significant cross-shareholdings among market participants, indication of a past or ongoing coordination or one party has a pre-merger market share of 50% or more.

Voigt/Schmidt[184] have demonstrated cases, in which thresholds of HHI levels were exceeded, however the market shares were below the thresholds that would give rise to competitive concerns. The wide discretion as well as the vague formulations (market share levels as well as concentration levels are only indicators) leave it absolutely open, how to solve such cases. It can be agreed with *Voigt/Schmidt*[185], that the guidelines are in this respect not particularly helpful and actually have increased uncertainty. For the merging parties this means that they have to consider market shares and concentration levels. If one result shows competitive concerns, they have to expect deeper assessments.

Further it has been criticized, that there will be cases, in which the Commission relies on the concept of single dominance and such cases, where it apllies unilateral effects analysis, applying unilateral effects analysis results may hardly be predicted.[186]

5.3.1.2 Anti competitive effects of horizontal mergers

For the purposes of the assessment of horizontal mergers the Commission distinguishes between non-coordinated (or unilateral) and coordinated effects.[187]

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[183]Horizontal Guidelines 19 et seq.
[184](2004) 1589 f. For example: Firm A and B with a market share of 8% and 10 % want to merge. Four remaining competitors have a market share of 20.5%. In such cases the Delta is 160, the post merger HHI is 2005.
[185](2004) 1589 et seq.
[186]*Baxter/Dethmer* (2005) 388, 389.
[187]See above Chapter 4.1.2.4. and 4.1.2.5.

5.3.1.3 Non-coordinated effects

Non coordinated effects are developments in markets, which lead to a reduction of competitive constraints and as consequence to price increases. Under price increases any possible competitive harm such as a reduction of output, choice or quality of goods and services or the reduction of innovation is understood.[188]

The most direct unilateral effect is the loss of the competition between the merging parties, other non-coordinated effects are reduction of competitive constraints in oligopolistic markets.

The following factors were considered to facilitate non coordinated effects[189]:

(i) Large post merger market shares;
(ii) Merging firms are close competitors (low product differentiation);[190]
(iii) Customers have limited possibilities switching supplier;[191]
(iv) Competitors are unlikely to increase supply, if prices increase;[192]
(v) The merged entity is able to hinder expansion by competitors;[193]
(vi) The merger eliminates an important competitive force, especially innovative firms exercise competitive pressure, for example, if they have promising pipeline products. The Commission explicitly enumerates the merger between two innovators.[194]

5.3.1.4 Coordinated effects

[188]Horizontal Guidelines para 8.
[189]See horizontal Guidelines 26 et seq.
[190]See above Chapter 4.1.2.4. The Commission for instance considered the market for equipment of hydro power stations as highly differentiated product market (M 3653, 13.7.2005, Siemens/VA Tech para 40).
[191]See above 4.2.1.1 Number of suppliers, market shares and concentration.
[192]See above 4.2.1.3 Barriers to expansion.
[193]See also above 4.2.1.2. Potential competition and barriers to entry.
[194]Horizontal Guidelines 38. This sanction for being too innovative is highly questionable. There is no empirical evidence that such a merger slows down and not accelerate innovation (see *Voigt/Schmidt* (2004) 1586).

Through the creation or strengthening of a collective dominant position a merger may significantly impede effective competition increasing the likelihood, that firms are able to coordinate their behaviour and raise prices (this may happen without resorting to a concerted practice within the meaning of Article 81 of the Treaty).[195] A merger may make coordination easier or more effective (in such a case firms were already coordinating their behaviour) either by making the coordination more robust or by allowing a coordination on higher prices.[196]

As it was already the practice under the old Merger Regulation the horizontal guidelines recognizes four conditions, which are necessary for coordinated behaviour to take place[197]:

(i) common understanding of profitable terms of coordination
(ii) ability to detect deviation
(iii) ability to punish deviation
(iv) outsiders should not be able to jeopardise the results of coordination

In assessing the likelihood of coordinated effects the Commission will - as under the old Merger Regulation - use all available relevant information.[198] In chapter 4.2.1.7 some factors and characteristics increasing the likelihood of coordination developed under the old Merger Regulation were listed. The horizontal Guidelines systematize these factors and characteristics facilitating coordinated behaviour assigning them to the above mentioned conditions. Some additional characteristics of a coordination facilitating economic environment listed in the horizontal Guidelines worth mentioning are:

(i) The reduction in the number of firms by itself facilitates coordination.
(ii) Volatile demand and substantial internal growth of some firms indicate that the economic environment is not stable enough for coordination.[199]

[195]See above 4.2.1.7 or horizontal Guidelines para 39.
[196]Horizontal Guidelines 39.
[197]See Above 4.2.1.7 or horizontal Guidelines para 41 or eg M 3653 13.7.2005, *Siemens/VA Tech* para 102.
[198]See above 4.2.1.7 or horizontal Guidelines para 42.
[199]Horizontal Guidelines para 45.

(iii) Structural links such as cross shareholdings or joint ventures may align incentives and facilitate monitoring deviations.[200]

5.3.1.5 Merger with a potential competitor

Anti-competitive effects (whether unilateral or coordinated) of mergers with potential competitors may only have significant anti-competitive effects, if [201]

(i) the potential competitor already exerts constraining influence, ie. it is likely that he might enter the market.
(ii) there is not a sufficient number of other potential competitors, which could maintain competitive pressure after the merger.

Both criteria require that a possible entrance would be profitable for the potential competitor.[202]

5.3.1.6 Mergers creating or strengthening buyer power in upstream markets

Concentrations creating or strengthening buyer power in upstream markets may put the buyer (merging parties) in a position to obtain lower prices by reducing its purchase of inputs. The Commission then considers two effects (one positive effect and one negative effect):[203]

(i) The lower input prices may lower the output level on downstream and final product markets[204];
(ii) If (i) is not the case increased buyer power on upstream markets may lead to lower price.

In the case of the second example approval under the old Merger Regulation might not be possible as a dominant position might be created or strengthened. This might be a gap case.[205]

[200]Horizontal Guidelines para 48.
[201]Horizontal Guidelines para 60.
[202]See above 4.2.1.2 Potential competition and barriers to entry.
[203]Horizontal Guidelines 61 et seq and Maudhuit/Soames 80.

5.3.1.7 Countervailing Buyer Power

As already mentioned above (chapter 4.2.1.8) countervailing buyer power exists, if customers have high market shares and have as a result the ability and the incentive after the merger to undertake strategies undermining the attempt of suppliers to increase prices.[206] Large and sophisticated firms are more likely to possess buyer power than small firms.

Strategies would for instance be to switch suppliers or at least part of the demand or to promote upstream expansion or entry. Buyer power may also be exercised, if the buyer refuses to buy other products produced by the supplier or if purchases are delayed.

Buyer power may however not be exercised, if the benefits of for instance a sponsored entry could also be reaped by competitors.[207]

In paragraph 67 the Commission makes an interesting remark regarding the scope of the offsetting effects of countervailing buyer power: It is not enough, if it only ensures that a particular segment of customers with particular bargaining strength is shielded from higher prices. The remark unfortunately leaves the question of what would be enough to offset the negative effects of concentration in downstream markets completely open.

5.3.1.8 Entry[208]

Potential entry of competitors is considered an important element of the overall assessment of a merger, as it may be a sufficient competitive constraint on the merging parties. Potential entry may therefore lead to the result that despite creating or strengthening a dominant position a merger might not significantly impede effective competition and has to be declared compatible with the common market.

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[204]The Commission refers to the Case M 1221 03/02/1999 Rewe/Meinl para 71-74.
[205]See *Röller/de la Mano* (2006) 20.
[206]See above 4.2.1.8
[207]Horizontal Guidelines para 66.

The Commission lists three conditions, which have to be fulfilled that the entry is considered a sufficient competitive constraint. An entry must be

(i) likely
(ii) timely and
(iii) sufficient to deter or defeat any competitive effect of the merger.[209]

Likelihood of entry requires that an entry must be sufficiently profitable for the entrant.[210]

The Commission considers a number of barriers to entry for instance if incumbents are able to protect their market shares with long term contracts, tariff or non tariff trade barriers, natural monopolies, intellectual property rights, economies of scale or distribution and sales networks.[211]

Paragraph 70 especially remains vague and unclear, when reference is made to historical examples of exit and entry in certain markets. The absence of past entry may be construed in two totally different ways. On the one hand it may indicate high barriers to entry on the other hand it may just reflect the effectiveness of competition in such markets.[212]

The appropriate time period, in which an entry has to be likely is depending on the characteristics of the markets. To defeat the potential anti-competitive effects it has to occur within two years to be considered *timely*.[213] Regarding the sufficiency of the threat of a potential entry the horizontal Guidelines remain vague, stating that a small-scale entry into some market niche may not be sufficient.[214]

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[208]See above 4.2.1.2 or M 3653, 13.7.2005, *Siemens/VA Tech* eg para 324.
[209]Horizontal Guidelines para 68. *Voigt/Schmidt* (2004) 1591 et seq were criticising the Guidelines as there were no explanations under what conditions potential competitors can constrain the behaviour of incumbents even if they never entered the market.
[210]See above 4.2.1.2.
[211]Horizontal Guidelines para 68-73.
[212]See above 4.2.1.2.
[213]Horizontal Guidelines para 74.

5.3.1.9 Efficiencies

Efficiencies[215] are for instance economies of scale, economies of scope, tax carry forwards, network effects, the internalisation of double mark-ups[216] or other advantages coming from the merger.[217]

With the entry into force of the new Merger Regulation a long debate in the EU whether efficiencies should be (positively) considered came to an end. Till this point rather to the contrary efficiencies were viewed as a reason for prohibiting a merger, if they would enable the parties to outperform their competitors (so called *efficiency offense*).[218] The Commission seems to have abandoned this view now stating in the non horizontal guidelines that:[219]

"…the fact that rivals may be harmed because a merger creates efficiencies cannot in itself give rise to competition concerns."

It is now clear that efficiencies brought about by a merger counteract anti-competitive effects. Under the old Merger Regulation the Commission was not able to consider such effects and as a result clear a merger.[220] Under the new Merger Regulation - and this constitutes one of the significant changes of the new substantive test – the Commission is now able to decide, that as a consequence of the efficiencies that the merger brings about, there are no grounds for declaring a merger incompatible with the common market.[221] The new substantive test shall in this respect give room to a more economic approach assessing mergers.[222]

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[214]Horizontal Guidelines para 75 see *Voigt/Schmidt* (2004) 1592, doubting if niche markets may not exercise competitive constraints.
[215]See above 3.1.1. or 4.2.4.2.
[216]In cases of vertical mergers the merged firm can capture a larger fraction of the benefits (mark-ups) and as a result be able to reduce prices on the downstream markets.
[217]Combining of strengths eg: Auto firm A may be better implementing innovative ideas and controlling quality, while auto firm B may be better in marketing and post sale servicing.
[218]See above 4.2.2, 4.2.3, 4.2.4.2, 5.3.2.4, etc.
[219]Non-horizontal Guidelines para 16.
[220]See above 4.2.4.2.
[221]See new Merger Regulation recital 29.
[222]*Maudhuit/Soames* (2005) 81.

Efficiencies can lead to such a result, if the merging parties provide the necessary evidence[223] that the Commission reaches the conclusion that the merger (cumulatively):

(i) is for the benefit of consumers
(ii) efficiencies are merger specific
(iii) efficiencies are verifiable.

The condition of *consumer benefit* is highly questionable (see chapter 2). The Commission is only taking such efficiencies into account, which benefit customers in those relevant markets where it is otherwise likely that concerns occur.[224] It not only refuses to consider efficiencies, which are not passed on to consumers[225] but also efficiencies, which would for instance take place in other markets. There does not seem to be a clear legal basis for this.[226]

Efficiencies not only have to be timely and substantial so as to outweigh anti-competitive effects.[227] The horizontal Guidelines unfortunately do not give guidance how to quantify efficiencies or negative effects such as for instance a decrease in innovativeness.[228]

Further efficiencies have to be a direct result of the notified merger and may not be achieved by less anticompetitive alternatives. Reasonable less competitive alternatives could be joint ventures[229] or licensing agreements. This has been criticised for being too stringent.[230] The reference to joint ventures as less anti-competitive alternative is very interesting: as joint ventures are concentrations within the meaning of article 3 of the new Merger Regulations. It implies that in such cases the efficiency defence might be successful, joint ventures thus have to be treated differently than other concentrations.

[223]The burden of proof of evidence is on the merging parties (Horizontal Guidelines 77, 87), see also *Williamson* (1968, 24).
[224]Horizontal Guidelines 79 or M 4000 4.7.2006 *Inco/Falconbridge* para 536, 544.
[225]Horizontal Guidelines 80, 84. Fixed costs are therefore not very likely to be considered.
[226]See above chapter 2.
[227]Horizontal Guidelines 79, 83.
[228] A calculation would obviously have to discount them.
[229]See Horizontal Guidelines 85 and 542.
[230]See *Maudhuit/Soames* (2005) 81.

Finally efficiencies have to *verifiable*, ie they have to be established credibly by the merging parties.[231] This also implies that efficiencies have to manifest immediately. *Rosenthal/Pate/Shores* argue that this is not justified as efficiency considerations are an integral part of a substantial analysis.[232]

As a result of this narrow approach there have been only very few cases[233] in which efficiencies played a role so far.

5.3.1.10 Failing firm defence

The horizontal Guidelines do not seem to change the assessment of mergers involving failing firms. It can therefore be referred to chapter 4.2.4.1.

5.3.2 Non-horizontal Guidelines

The non horizontal Guidelines are aimed to develop guidelines how the Commission assesses concentrations, where the merging parties are in contrast to the horizontal guidelines active on different markets. Two types of non horizontal mergers, vertical and conglomerate are distinguished. Vertical mergers involve companies operating at different levels of the supply chain. Conglomerate mergers are mergers between firms that are in a relationship, which is neither horizontal nor vertical. In practice the focus is on mergers between companies active in closely related markets.[234]

As non-horizontal mergers do not reduce direct competition of the merging firms in the same markets the Commission considers them generally less likely to significantly impede effective competition.[235]

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[231]See Horizontal Guidelines 86 et seq. The burden of proof is on the merging parties.
[232]*Rosenthal/Pate/Shores* (2007) 32. See also The joint Comments of the American Bar Association's Section of Antitrust Law and Section of International Law on the European Commission's Draft Guidelines on the Assessment of Non-Horizontal Mergers Under the Council Regulation on the Control of Concentrations Between Undertakings (hereafter Comments of the American Bar Association) 6.
[233]Eg M 4000 4.7.2006 *Inco/Falconbridge* para 529 et seq.
[234]Non-horizontal Guidelines para 5.
[235]Non-horizontal Guidelines para 11 et seq. Comments of the American Bar Association 4 note to the corresponding and not changed passage in the Draft Guidelines that the Guidelines should be more explicit in confirming that non-horizontal mergers only infrequently give rise to competition concerns.

The Commission distinguishes as in the horizontal Guidelines between coordinated and non-coordinated effects.[236]

Regarding non-horizontal mergers non coordinated effects are mainly seen in foreclosure. Foreclosure describes, when actual or potential competitors' access to supplies or markets is hampered or eliminated[237] as a result of the merger, thereby reducing these companies' ability and or incentive to compete.[238]

The merged firm may as a result of the merger choose to restrict supplies or to raise the price. It may also opt for a specific technology within the new firm, which is not compatible with the products of the downstream competitors.[239] Besides foreclosure a unilateral effect of a non horizontal merger could be the access to commercially sensitive information of competitors allowing for instance to price less aggressively in the downstream markets.[240]

Non-horizontal mergers only pose a threat to effective competition, if the merged entity has at least on one of the markets concerned significant market power. As a threshold under which it is unlikely, that the Commission finds concern in horizontal mergers the Commission mentions a market share of 30% and a post-merger HHI below 2000 in all of the concerned markets.[241] In practice mergers below these values will not be extensively investigated unless[242]:

(i) a company is involved, which is likely to expand significantly in the near future,
(ii) significant cross shareholdings or cross directorships among the market participants can be observed,

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[236]Non-horizontal Guidelines para 17 et seq.
[237]The Comments of the American Bar Association, 5 consider the definition incomplete lacking objective criteria of how foreclosure resulting from less than complete elimination of access or supplies is addressed.
[238]Non-horizontal Guidelines para 18 or 29.
[239]Non-horizontal Guidelines para 33.
[240]Non –horizontal Guidelines para 78.
[241]Non -horizontal Guidelines para 25. The Comments of the American Bar Association (9) and of Studienvereinigung Kartellrecht E.V. (4) regarded these levels as too conservative. Further it remains unclear how these thresholds have to be applied in cases of conglomerate mergers (see Comments American Bar Association 20).

(iii) one of the merging firms is a firm with a high likelihood of disrupting coordinated conduct,

(iv) indications of past or ongoing or facilitating practices are present.

5.3.2.1 Vertical Mergers

Analysing vertical mergers the Commission considers pro- and anti-competitive effects (efficiencies).[243] Especially vertical mergers may be pro-competitive through the internalisation of double mark-ups, the decrease of transaction costs and the possibility of "one stop shopping".[244]

5.3.2.2 Non-coordinated effects in vertical mergers

The most important coordinated effect of vertical mergers is foreclosure, when actual or potential competitors' access to supplies or market is hampered or eliminated. Two forms of foreclosure are distinguished on the one hand *input foreclosure* on the other hand *customer foreclosure*. In practice the Commission examines the following factors, when assessing vertical mergers potentially giving rise to input or customer foreclosure (*three step test*)[245]:

(i) ability to foreclose access to inputs/downstream markets

(ii) incentive to foreclose access to inputs/downstream markets

(iii) overall likely impact on effective competition.

5.3.2.3 Input foreclosure

Input foreclosure happens when post-merger the new entity would be likely to restrict access to its products and services thereby raising the downstream rivals' costs making it harder form them to obtain supply. This may lead - if there are no

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[242]Non -horizontal Guidelines para 26.
[243]Non-horizontal Guidelines para 21, 52, 58.
[244]Non-horizontal Guidelines para 13 et seq.
[245]Non-horizontal Guidelines para 32, 59.

efficiencies resulting from the merger - to a price increase on the downstream markets.[246]

In principle the explanations of the Commission regarding the *ability to foreclose* stay vague emphasizing that strategies and counterstrategies of competitors have to be considered evaluating the effects of a merger.[247] The Commission reviews possible strategies of market participants. Input foreclosure may only happen regarding important inputs. This is the case, when the input is an important cost factor of the product on the downstream market or the input product is a critical part of the downstream product or an important source of product differentiation.[248] The vertically integrated firm must further have a significant degree of market power on the upstream market. The ability to foreclose only exists, if it can negatively affect the overall inputs of the downstream market.[249] This may for instance be the case if upstream suppliers face barriers to expansion.[250] If the upstream market is oligopolistic the restriction of access strengthens the market power of the remaining upstream suppliers, which can trigger unilateral or coordinated effects.[251]

An *incentive to foreclose access* to inputs for competitors arises when the profit lost in the upstream market due to a reduction of input sales is lower then the expected short- or long term profit gain from price or sales increases downstream.[252] As a result the lower the margins upstream and the higher the margins and market shares downstream are, the higher is the incentive of foreclosure. The ability to increase sales downstream may on the one hand depend on (non-) existing barriers to expansion and on the other hand on the ability to get sales from competitors (closeness of products). Even if foreclosure would be unlawful, for instance as a result of sector specific rules, this would not totally rule out such a strategy. However the Commission considers legal restrictions as disincentives of foreclosure.[253]

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[246]Non-horizontal Guidelines para 31.
[247]Non-horizontal Guidelines para 39.
[248]Non-horizontal Guidelines para 33 et seq.
[249]Non-horizontal Guidelines para 36.
[250]See above 4.2.1.3.
[251]Non-horizontal Guidelines para 38.
[252]Non-horizontal Guidelines para 40.
[253]Non-horizontal Guiedlines para 46 (input foreclosure), 71 (customer foreclosure).

As third criterion of the three step test the Commission evaluates the *overall likely impact on competition*.[254] As already mentioned when a vertical merger allows the merging parties to increase the costs of downstream competitors this leads to an upward pressure on sales prices. Vertical integration may significantly impede competition by raising barriers to entry to potential competitors, for instance if after a vertical integration potential entrants would be forced to enter at both the upstream and the downstream markets.

Further the Commission has to consider efficiencies[255] brought about by a vertical merger. In general the Commission applies the principles set out in Section VII of the horizontal Guidelines.[256]

In the context of vertical mergers in particular the internalisation of pre-merger existing double mark-ups resulting from both parties setting their prices independently could be an efficiency. However vertical cooperation or vertical agreements may short of a merger achieve equal benefits with less anti-competitive effects.[257] In these cases efficiencies are not acknowledged as the efficiency is not merger specific. Additionally the Commission refers to the case, when the supply of input is limited by capacity constraints and there is an equally profitable alternative use of the input. In such circumstances the alternative use entails an opportunity cost for the vertically integrated firm. As a result there is an incentive for the merged firm not to internalise double mark ups, on the other hand there is also an incentive not to foreclose third parties.[258]

5.3.2.4 Customer foreclosure

When a supplier merges with an important customer on the downstream market customer foreclosure may take place. The Commission concludes that this may

[254]Non-horizontal Guidelines para 47-57.
[255]Efficiencies are in detail discussed above in chapter 2, chapter 4.2.4.2 and chapter 5.3.1.9
[256]Non-horizontal Guidelines 55. It is however very questionable, if in constellations, which in general give less rise to competition concerns, such as non-horizontal mergers the conditions for proving efficiencies for the parties should be the same as in horizontal mergers and not lowered.
[257]Non-horizontal Guidelines para 55.
[258]Non-horizontal Guidelines para 55 footnote 55.

reduce the upstream competitors ability or incentive to compete.[259] The reduction of customers should however first of all increase the competition amongst the remaining firms upstream. The argument of the Commission reminds one of the highly questionable and criticised efficiency offense.[260] Another effect may be the rise of the costs of downstream competitors as it might become harder for them to obtain supplies. As a result prices may rise on the downstream markets.[261]

The *ability to foreclose* depends primarily on the fact that there are no sufficient economic alternatives in the downstream markets for upstream competitors. Therefore foreclosure can only take place, if a company with sufficient market power on the downstream market is involved.[262]

The profitability of customer foreclosure (and therefore the *incentive to foreclose access to downstream markets*) depends on the trade-off between the likely costs of not procuring products from upstream rivals downstream and the possible gains from doing so. Costs of not procuring products of rivals are high, if they are able to deliver with lower prices than the upstream division of the merged entity. An incentive for foreclosure is low if the upstream division is capacity constrained or the competitors products are more attractive.[263] Possible gains from foreclosure encouraging such a strategy would for instance be higher price levels downstream.[264]

Assessing the *overall likely impact on effective competition* in cases of customer foreclosure the Commission considers just as in the cases of input foreclosure remaining competition in the markets as well as efficiencies.[265]

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[259]Non-horizontal Guidelines para 58. In paragraph 65 (and similar paragraph 72 et seq) of the non-horizontal Guidelines the Commission states, that when customer foreclosure primarily impacts on the revenue streams of upstream rivals it may significantly reduce their ability and incentive to invest in cost reduction and product quality. The question is why? The competition got harder as demand (customer) went down, the incentive to cost reduction or quality increase should rather increase. Also the incentive to differentiate products should in such a situation increase. See paragraph 67, where the Commission considers a more aggressive strategy.

[260]See above 5.2.1.2.6. For a description of decisions arguing with an *efficiency offense* see *Böge/Jakobi* (2005) 115.

[261]Non-horizontal Guidelines 58.

[262]Non-horizontal Guidelines 61. This addresses only part of the story, as the structure of both the upstream and the downstream market must support the emergence of market power. Also the upstream firm must absorb enough demand to impact other competitors (see Comments American Bar Association 14).

[263]Non-horizontal Guidelines 69.

[264]Non-horizontal Guidelines 70.

[265]Non horizontal Guidelines 74-77.

5.3.2.5 Coordinated effects of vertical mergers

The remarks of the Commission to coordinated effects of vertical mergers are a mere application of the horizontal Guidelines regarding these kind of effects. In principle it can therefore be referred to chapters 5.3.1.4 and 4.2.1.7 Vertical mergers may facilitate the conditions for coordinated behaviour such as the understanding of profitable terms of coordination,[266] the ability to detect[267] and punish deviation[268] may be made easier. On the other hand the ability of outsiders to jeopardise the results of coordination may be aggravated by the merger.[269]

The Sections of the American Bar Association noted in their comments to the draft of the non horizontal Guidelines that vertical mergers usually have much greater potential to destabilize coordination than to increase the likelihood of coordination and this was not expressed sufficiently.[270]

5.3.2.6 Conglomerate Mergers

Conglomerate mergers are mergers between firms that are neither competitors in the same markets (horizontal mergers) nor in a customer-supplier relationship (vertical mergers). As a rule such mergers are not deemed to be problematic.[271] Following its approach discussing horizontal or vertical mergers the Commission distinguishes non coordinated and coordinated effects.

5.3.2.7 Non coordinated effects of conglomerate mergers

Most important non coordinated effect is again - as it is the case in vertical mergers - deemed to be foreclosure. Foreclosure may happen if a combination of products in

[266]Non-horizontal Guidelines para 82 et seq. A vertical merger may result in the reduction of effective competitors in the market, which makes it easier to coordinate among the remaining market players. It may also increase the degree of symmetry between the firms.
[267]Non horizontal-Guidelines 86 et seq. Monitoring deviation may be easier if the merger gives access to sensitive information.
[268]Non horizontal Guidelines para 88. A vertically integrated firm may be in a position to more effectively punish competitors because it is a crucial customer or supplier to them.
[269] Non-horizontal Guidelines para 85, 89, 90.
[270]Comments American Bar Association 19.

related markets confers of the merged entity the ability and incentive to leverage a strong market position from one market to another.[272] The Commission distinguishes between pure bundling, when products are sold only jointly in fixed proportions and mixed bundling, when products are available separately but the sum of the stand alone prices are higher than the price of the bundle.[273]

The Commission examines in the so called *three step test* if there is the ability and secondly the incentive to foreclose. As last step the overall impact of prices and choices is assessed.[274]

Only competitors with a significant degree of market power, which does not necessarily amount to dominance, are expected to have the *ability to foreclose competitors*.[275] Condition for successful bundling or tying is first of all, that there is a (large) common pool of customers for the bundled or tied goods or services, or in other words, a large fraction of output has to be affected by foreclosure.[276] At least one important product of the merged entity has to be involved.[277] Bundling and tying may be a very successful strategy, if network externalities are in the play. Especially such a strategy may raise entry barriers.

On the other hand the Commission considers that there may be successful counterstrategies in cases of bundling or tying. For instance, it may be combated, if single companies combine their offers, or if bundled products could be resold profitably. Bundling or tying may also entail more aggressive competition and be therefore pro-competitive.[278]

Considering the incentive or profitability to tie and bundle the merged entity faces a trade-off between the possible costs associated with bundling and tying its products

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[271]Non-horizontal Guidelines para 92.
[272]Non-horizontal Guidelines para 93, for a definition of bundling and tying see above 4.2.3.
[273]Non- horizontal Guidelines 96.
[274]Non-horizontal Guidelines para 94 – 118.
[275]Non-horizontal Guidelines para 99.
[276]Non-horizontal Guidelines para 100, 113. The American Bar Association noted that thresholds values that would serve as safe harbour should be mentioned (see Comments American Bar Association 19).
[277]Non-horizontal Guidelines para 99. The importance of a product is assumed, if there are only a few alternatives or if products are seen by customers as so called "must stock products". Tying and bundling may also be facilitated, if there are barriers to expansion.

and the possible gains from expanding market shares.[279] The relative value of products may therefore be decisive.[280]

Discussing the *overall likely impact on prices and choice* the Commission admits - obviously putting its efficiency offense into perspective – that the reduction in sales by competitors cannot be considered in and of itself a problem.[281] Yet in particular industries - the Commission goes on to say – the reduction in the competitors' ability or incentive to compete may not be reduced. The Commission seems to regard such developments as anti-competitive effects. Another possible anti-competitive effect of tying and bundling practices may be the deterring of potential competitors to enter the market. Bundling and tying may force potential entrants to enter the product markets of the tied and the tying good.

The Commissions' remarks discussing *efficiencies* brought about by conglomerate mergers are interesting. First the Commission refers to the explanations in the context of vertical mergers. Then the so called "Cournot effect" is discussed. In certain cases - yet this is not the rule - firms may consider the effect of a drop in the price of their product on the sales of another product. By mixed bundling firms may try to make the most out of such effects. This may give an incentive to lower margins.[282]

Economies of scope, which are an inherent advantage to supplying goods together rather than apart, as well as the fact that bundled or tied products are marketed together or are better compatible are considered necessary but not sufficient for an efficiency justification.[283]

5.3.2.8 Co-ordinated effects of conglomerate mergers

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[278]Non-horizontal Guidelines para 103.
[279]Non-horizontal Guidelines para 105.
[280]The merged firm will probably not risk to lose sales in highly profitable market to expand in a market where expected profits are modest (see Non horizontal Guidelines para 107).
[281]Non-horizontal Guidelines para 111.
[282]Non-horizontal Guidelines para 117.
[283]Non-horizontal Guidelines para 118.

The Commission refers mutatis mutandis to the framework set out in the horizontal Guidelines.[284] Especially multi market competition may facilitate coordination by increasing the scope and effectiveness of disciplining mechanisms.

6. The substantive test of section 12 para 1 No 2 of the Austrian Cartel Act 2005

As already mentioned above[285] Austria besides Germany, Italy and Luxembourg were opposing the proposal to introduce the SLC-test in European merger control insisting on the existing single dominance approach (hereafter also structural approach). The legislator also kept this approach passing the Austrian Cartel Act in 2004 and did not follow the development described above in the European merger control from single dominance to the broader approach such as the SIEC-test.[286] The Austrian substantive test is applied for mergers, with a sufficient relation to the Austrian economy below the thresholds of Article 1 of the Merger Regulation.

It shall now be compared with the effects based SIEC-test. Finally the question, if such an approach could be unconstitutional with regard to the fundamental right of equal treatment (reasonableness of rules) shall be asked.

The application of EU-merger control is restricted to mergers with Community dimension. According to Article 1 Merger Regulation it shall only be applied to mergers above the thresholds mentioned there. Below these thresholds the member states are free to implement (national) rules controlling concentrations (subsidiarity principle EC Art 5).[287] Thus the old and the new Merger regulation does not give a standard to measure national merger control.

6.1 According to section 12 para 1 No 2 of the Austrian Cartel Act 2005 (hereafter Austrian test) the cartel court has to prohibit a concentration, if it can be expected,

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[284]Non-horizontal Guidelines para 119. See above 5.3.1.4.
[285]See above 5.1.
[286]See *Reidlinger/Hartung* (2006) 174 et seq or *Hoffer* (2007) 177 or *Petsche/Urlesberger/Vartian* (2007) 293.
[287]For a long time some member states chose to have no national merger control (comp the development of Art 22 of the Merger Regulation (so called “dutch clause”)).

that the merger creates or strengthens a dominant position. Explaining the dominant position it is referred to Section 4 leg cit where a dominant position is described.

A dominant position is described in Section 4 leg cit, when a supplier or customer is (i) not or insignificantly exposed to competition or (ii) has in relation to competitors a paramount market position, especially regarding the financial standing, relations to other enterprises, entry opportunities to supply and sales markets and entry barriers for other enterprises.

Paragraph 2 of Section 4 of the Austrian Cartel Act then goes on to make presumptions, when a dominant position is assumed. A dominant position is assumed, when an enterprise has market shares in the domestic market or other relevant local markets of (i) 30% or more or (ii) market shares of more than 5% and faces only competition of two more market participants or (iii) market shares of more than 5% and the firm belongs to the four largest enterprises in the market, which all together have a market share of 80% or more.

Even if a dominant position is created or strengthened mergers have to be allowed, if it has to be expected that the intended merger will improve conditions of competition, however only structural improvements in other markets can be taken into consideration, efficiencies are not considered as a possible justification of a merger.[288] Further - pursuant Section 12 para 2 No 2 of the Austrian Cartel Act 2005 - concentrations must not be prohibited, if the merger is necessary for the maintenance or improvement of the international competitiveness of the merging parties and such a decision is economically justified.

6.2 As already described above (chapter 4.2.1.4 et seq) single dominance test and (unilateral) effects analysis are different concepts. While the single firm dominance test is based on the monopoly model, the unilateral effects theory is based on game theory and the oligopoly model. Dominance analysis relies on the market structure, unilateral effects analysis examines effects and new price equilibriums caused by concentrations. This also reflects the different goals of the concepts, while the

[288]See *Hoffer* Kartellgesetz 2007 181 or *Petsche/Urlesberger/Vartian* (2007) 56. The situation is similar in Germany (see *Böge/Jakobi* (2005) 116 et seq).

dominance test protects the structure of the market unilateral effects analysis considers the consequences of mergers on prices, quality etc.

6.3 Comparing the results of the two concepts one maybe lead to the conclusion that under the structural approach of the Austrian merger control certain situations of underinforcement and on the other hand, situations, where pro competitive mergers are not allowed may occur, for instance:

(i) While in European Merger Control efficiencies can be taken into consideration the structural approach of the Austrian test does not allow the consideration of efficiencies.
(ii) Mergers where single dominance replaces collective dominance may so disrupt the market that further coordination is impossible. Such mergers cannot be allowed under the structural approach.
(iii) Mergers with high market shares involving markets with highly differentiated products may not have anticompetitive effects. Also such mergers cannot be permitted under a structural approach.
(iv) The takeover of potential entrants exercising constraint on market participants by a non dominant firm cannot be considered under the structural approach.
(v) The acquisition of a small and innovative firm to prevent or delay the introduction of a new product by a non dominant firm may not be prevented under the structural approach.
(vi) Mergers between not dominant up-or downstream firms, when the upstream firm has after the merger less incentive to engage in price cutting to serve downstream firms cannot be prohibited under the structural approach. (raising rivals' costs).
(vii) Mergers of non dominant firms in up- or downstream markets reducing countervailing buyer power (eg spin of off a firm that exercises countervailing buyer power) cannot be prohibited under the structural approach.

While the approach of the Austrian Cartel Act protects the structure of markets (the existence of competition) regardless of effects of mergers, the SIEC-test goes one step further also looking at effects of such structural changes on markets (prices, quality).

The advantage of the shorter structural approach of the Austrian Cartel Act is surely the easier predictability of the outcome of the review process of mergers.

The structural approach in contrast to SIEC – test is a concept that does not attempt to predict the outcome of mergers as this - in the light of various economic theories, models and approaches – may be regarded a too difficult task.[289]

An effects based approach in contrast to mere structural appraisal criteria must lead to less legal certainty and substantial higher costs of the parties, especially if they want to prove efficiencies.[290]

Comparing the approaches it becomes once again clear, that the structural approach and effects based analysis such as the SIEC-test rely on fundamentally different concepts and pursue different goals. Especially for national merger legislation (below thresholds) the less sophisticated and therefore less costly approach may seem more appropriate. Neither the principle of equal treatment (reasonableness of legislation)[291] nor the protection of property[292] restrict the legislator, which goals to pursue.[293] It is in the discretion of the legislator to decide on economic policies. Thus choosing a structural approach does not raise concerns regarding constitutional law.

7. Summary

The new substantive test reflects and develops the experience gained in the years of application of the old substantive test under the old Merger Regulation. It adapts the criteria for the assessment of mergers to new economic developments.

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[289] See *Christiansen* (2005), 285.
[290] See *Christiansen* (2005) 291 or *Böge/Jakobi* (2005) 119.
[291] Eg Art 7 of the Austrian Federal Constitution, or Art 2 Staatsgrundgesetz.
[292] Eg Art 1 Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms or Art 5 Staatsgrundgesetz.
[293] See *Berka* Grundrechte 1999, 514.

There are however under the regime of the new SIEC-test some cases which were decided differently than under the old structural approach.[294]

It clarified the expressed uncertainty regarding the alleged oligopoly blindspot. It moved the appraisal criteria of mergers towards the SLC-test and therefore stepped in the direction of a global standard of merger control. It is undisputed that the new test is not a big change in merger control,[295] albeit it seems as if a new European substantive test was developed.

The largest change is the more economic (or more sophisticated) approach. The change also manifests in the reasoning of decisions, which as a result of sophisticated economic analysis increased in volume.

The more economic approach reflected in the new substantive test gives the Commission wider leeway. This uncertainty created with the new test is encountered with the issuing of the horizontal and the non-horizontal Guidelines improving the efficiency, consistency and transparency of the merger review process.

The discussion of the issued Guidelines however showed that there are still areas, where legal uncertainty is quite high.[296]

A very controversial topic will be the treatment of efficiencies, especially the wide discretion of the Commission and the burden of proof. Although the new test in contrast to the old appraisal criteria rendered the opportunity to consider efficiencies the Guidelines and the decisions of the Commission still have a very restrictive attitude, which makes one come to the conclusion that in practice the intended change towards a less restrictive practice did not take place. The Commission however seems to further abandon argumentations commonly described as efficiency offense.[297] It still stays very unclear in this respect, where and when the protection of competitors is considered.

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[294]See above 5.2.
[295]See *Immenga/Körber* in Immenga/Mestmäcker (2007) Art 2 para 184. *Böge*, (2004) 143 et seq or *Staebe*, (2004), 195; *Völcker* (2004) 395. *Röller/ de La Mano* (2006) 23 et seq.
[296]See above chapter 5.3.1.1. Market shares and concentration levels.

Further there seems to be a fundamental misconception when applying efficiencies only if a consumer benefit can be observed. The Commission not only refuses to consider efficiencies, which are not passed on to consumers[298] but also efficiencies, which would for instance take place in other markets. There does not seem to be a legal basis for this.[299]

National Austrian merger control applies a fundamentally different substantive test (structural approach), which is more oriented on the appraisal criteria preceding the SIEC-test. The implementation of such a less sophisticated approach seems for small mergers more appropriate. Choosing a structural approach by the national legislator does therefore not raise constitutional concerns.

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[297]See above 4.2.2 and 4.2.3.
[298]Horizontal Guidelines 80, 84. Fixed costs are therefore not very likely to be considered.
[299]For the reasoning see above chapter 2.

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