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A Contextual analysis of the 2004 revisions to the substantive test for competitive harm in the EU Merger Regulation.

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INTRODUCTION AND AIMS

Council Regulation (EEC) 4064/89 of 21 December 1989 on the Control of Concentrations between Undertakings [1989] OJ L395/1[1] (1989 MR) prohibited a concentration that "creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market".[2] The existing regulation was replaced by Council Regulation (EC) 139/2004 on the control of concentrations between undertakings (the EC Merger Regulation) [2004] OJ L24/1,[3] which prohibits a concentration that "would significantly impede effective competition, in the common market ... in particular as a result of the creation or strengthening of a dominant position".[4] By changing the word order in this way, the current regulation removes the emphasis from discovering of "dominance" and places

[1] EC Merger Regulation 4064/89.
[2] ibid art 2(3).
[3] EC Merger Regulation 139/2004.
[4] ibid art 2(3).

it upon finding of "significant impediment to effective competition" (SIEC).[5]

This paper focuses on whether the 2004 revisions came not a moment too soon. The claim assumes three conjectures. First, that the change was real and substantial, not merely semantic. Secondly, that the revisions did not come at the first opportunity. Thirdly, that the revisions came in time to avert further potential problems, which existed due to faults in the older system. The present paper evaluates each of the arguments in turn by looking at the historical context of the revisions, while comparing practical and theoretical implications of both regimes.

SUBSTANTIAL DIFFERENCES BETWEEN THE OLD AND THE NEW TESTS

In order to assess substantial changes between the two tests, it is necessary to settle on their definitions. The wording of the 1989 test creates some ambiguity and allows two interpretations.[6] This paper assumes that the old test requires both "dominance" and SIEC to be present as this interpretation has been endorsed by the majority of economists and the courts.[7] In contrast, the new substantive test practically removes "dominance" as a requirement altogether.[8]

Supporters of the SIEC test claim that it introduced two improvements over the old system. First, it allows the regime to be in alignment with other jurisdictions around the world, including US and commonwealth countries.[9]

[5] Stefan Thomas and Michael Rosenthal, *European Merger Control* (Hart Publishing, Oxford 2010) 86.
[6] Kyriakos Fountoukakos and Stephen Ryan, 'A New Substantive Test For EU Merger Control' [2005] ECLR 277, 280.
[7] Lars-Hendrick Roller and Miguel La Mano, 'The Impact of New Substantive Test In European Merger Control' (2006) 2 ECJ 9, 14.
[8] ibid 16.
[9] Zoltan Biro and David Parker, 'A New EC Merger Test? Dominance v Substantial

Secondly, it introduced an effects-based analysis of competitive harm, which is superior to structure-based analysis of the old test as it allows to assess unilateral anti-competitive effects.[10] This paper concentrates on the second claim.

The distinction between the two approaches has deep historical roots. The structure-based analysis comes from the German economic theory of Ordoliberalism, which stressed the importance of preventing any "dominance" in the market. Hence the old test examined market shares, sizes of undertakings, etc.[11] However, there may be situations where market shares overstate the significance of a merger. For example the merger in *United States v Von's Grocery Co*[12] "lessened competition" that made almost no effect on the market. In Europe, the application of the old test would have prevented such merger, even though very little anti-competitive harm would have been caused. The effects-based analysis has originated from the Chicago school of thought, which emphasised considering the effects of the merger on the market. This allows agencies to take efficiencies into account. Disregarding efficiencies leads to errors in analysis.[13]

The emphasis on the "lessening competition" aspect of a merger may lead to errors in analysis as it ignores unilateral behaviour of each of the market players.[14] This is particularly the case if the merging entities are close competitors, as close competitors, even with a small market share, would inflict greater competitive constraints on each other compared to distant competitors.[15] The problem with the structure-based approach is that it cannot

Lessening of Competition' [2002] 1 Comp Law 157, 157.
[10] ibid.
[11] Fountoukakos (n 6) 289.
[12] *United States v Von's Grocery Co* 384 US 270 (1966).
[13] Roller (n 7) 17.
[14] Cosmo Graham, *EU and UK Competition Law* (2nd edn, Pearson 2013) 496.
[15] Simon Baxter and Frances Dethmers, 'Unilateral Effects Under the European Merger Regulation: How Big is the Gap?' [2005] ECLR 380, 387.

evaluate the "closeness" of the competitors.[16] The new SIEC test solves this problem by considering all effects, even when "lessening competition" is not present. One example of the advantage of the effects-based approach is *FTC v HJ Heinz Co*,[17] where the merger between the second and the third market leaders could not create a dominant position, but could cause unilateral anti-competitive effects on the market. The competition between the merging parties exerted competitive pressure on the market leader, which would have been lost if the merger were allowed. Such merger would not have been prohibited under structure-based "competition"-focused test.[18]

Not everyone has agreed that the SIEC test brought substantial changes to the analysis of merger cases. German academics Ulf Boge and Edith Muller considered criticisms of the "dominance" test with regard to unilateral effects to be an "illusory argument".[19] Being of German origin, the two economists, possibly, felt naturally more sympathetic to the theory of Ordoliberalism. However, a British economist, Simon Bishop, also stated that in practice there was little difference between the "analysis undertaken or the outcome of that analysis under the two tests".[20] He argued that unilateral effects could be "caught" by the "dominance" test if markets were defined narrowly enough.[21]

On the balance, it seems that the majority of academia considers differences between the two tests "more substantial than semantic."[22] Bishop's arguments that the changes brought by the 2004 revisions were unnecessary, do not suggest, however, the lack of practical implications. The following section of

[16] ibid.
[17] *FTC v HJ Heinz Co* 246 F3d 708 (DC Cir 2001).
[18] Fountoukakos (n 6) 290.
[19] Ulf Boge and Edith Muller, 'From the Market Dominance Test to the SLC Test: Are There Any Reasons for a Change?' [2002] ECLR 495, 499.
[20] Simon Bishop and Mike Walker, *Economics of EC Competition Law* (3rd edn, Sweet & Maxwell 2010) 360.
[21] ibid 358.
[22] Gotz Drauz and Michael Reynolds (eds), *EC Merger Control A major Reform in Progress* (International Bar Association, London 2002) 179.

the present paper discusses whether the changes were implemented as the right time or were unreasonably delayed.

EARLY CALLS FOR THE REVISION

This section will discuss whether it was possible to implement the revisions earlier than in 2004. It looks at pre-2004 case law and academic articles from the European Union and United States, to investigate whether the idea for the change had developed long before the current regulation came into force.

A few years before the revisions were introduced, the European Commission (EC) had faced several problematic cases, which may have pushed the reform forward. Since under the previous regime no merger could be prohibited unless "dominance" was discovered, the Commission had to use the concept of "collective dominance" when analysing mergers in an oligopoly.[23] However, there is a limit on how far this concept may be expanded. In *Airtours v Commission*[24] the Court of First Instance rejected the prohibition of a merger, imposing conditions on when "collective dominance" may apply.[25] That case was not the first one to raise problems associated with "collective dominance". In 1998, it was held in *France v Commission*[26] that the Commission did not have enough proof of existence of "collective dominance".[27]

These cases highlighted problems with the existing substantive test and intensified calls for the change. In September 2000, a head of the enforcement unit of the EC's Merger Task Force was already openly discussing a "large

[23]Graham (n 14) 492.
[24] Case T-342/99 *Airtours v Commission* [2002] ECR II-2585.
[25] ibid para 62.
[26] Case C-68/94 *France v Commission* [1998] ECR I-1375.
[27] ibid para 271.

gap" of the "dominance" test in relation to unilateral effects.[28] Many articles were published on the topic following the release by the EC of a Green Paper[29] in December 2001 on the review of the 1989 MR, which raised concerns in relation to potential limitations of the "dominance" test.[30] Economists Zoltan Biro and David Parker wrote in 2002 that there were "certain arguments for replacing the dominance standard" and that "the obvious alternative" would be the effects-based test.[31] Sir John Vickers in his speech at the International Bar Association Conference in 2002 stated that "it cannot safely be assumed that the existing EC Merger Regulation dominance test covers all anti-competitive mergers of concern. The test needs to change."[32] The same year, a leading antitrust lawyer Nicholas Levy explained that the advantages of an effects-based test over the "dominance" one is that the former comprehends competitive harm in virtually all situations, while the latter may miss out on "transactions that have unilateral effects, falling short of single-firm dominance".[33]

European academia had clearly been aware of the problems associated with the existing test well before the 2004 revisions took place. It can be argued that principal academic criticisms arose mainly due to publishing of the Green Paper[34] and were inspired by the recent case law. However, it is likely that their concerns had been already well known and established for quite some time at that point.

The effects-based test has been used in practice in many other jurisdictions

[28] Fountoukakos (n 6) 283.
[29] Commission, 'Green Paper on the Review of Council Regulation (EEC) 4064/89' COM (2001)745 final.
[30] ibid para 166.
[31] Biro (n 9) 165.
[32] Drauz (n 22) 181.
[33] ibid 144.
[34] Commission, 'Green Paper on the Review of Council Regulation (EEC) 4064/89' COM (2001)745 final.

for many decades. In the United States a debate on its advantages over a structure-based approach has a particularly long history. In 1963 the United States Supreme Court created a presumption that mergers that covered a significant market share were unlawful.[35] Such a focus on the market share analysis led to a prohibition of a merger in *Von's Grocery*,[36] mentioned above. In that case Justice Stewart dissented and criticised the existing system by stating that "the sole consistency that I can find is that ... the Government always wins."[37] However, eight years later in *United States v General Dynamics Co*,[38] Justice Stewart, this time in majority, explained that market share statistics, although extremely relevant, were not dispositive.[39] This summarises ineffectiveness of the structure-based analysis as mere market share information is not sufficient to determine whether merger effects are harmful. Legislators and commentators on the other side of the Atlantic knew very well about these developments of the American case law, however the push towards the SIEC-type test did not occur until almost 30 years after Justice Stewart's judgement.

POST-2004 MERGER DECISIONS

This section of the paper discusses the post-2004 merger decisions in the European Union and whether any undesirable outcomes have been averted by the implementation of the SIEC test. The following three decisions are the examples of attempted horizontal mergers.

T-Mobile Austria/Tele.ring[40] was a decision on a merger between the second and fourth largest mobile phone operators in Austria, which could not have made the merged entity a market leader. However, due to the elimination

[35] *United States v Philadelphia Nat'l Bank* 374 US 321, 365 (1963).
[36] 384 US 270 (1966).
[37] ibid 301.
[38] *United States v General Dynamics Co* 415 US 486, 511 (1974).
[39] ibid 511.
[40] *T-Mobile Austria/Tele.ring* (Case COMP/M3916) [2007] OJ L88/44.

of one of the players the merger could bring about anti-competitive unilateral effects such as the weakening of competitive pressure. In practice that could mean that prices would unlikely to continue to fall as significantly as they used to in the past.[41] Some critics argued that the real concern of the merger was a "maverick" behaviour of one of the merging parties. As this relates to coordinated effects, the decision does not prove an existence of a "gap" in the old test.[42]

In *Siemens/VA Tech*[43] the merger could have resulted in a weakening of a competitive force, without creation of "dominance". The EC approved the merger, but in its analysis largely ignored market share distribution and concentrated instead on how closely the potential merging parties were competing.[44] However, some argued that the EC was also taking into account leading positions of the merging parties in the market.[45] As such it is not clear whether the merger could have also been challenged under the "dominance" test.[46]

In *Hutchison 3G UK/Telefónica UK*[47] the EC has banned the merger of O2 and Three mobile networks, taking into consideration possible increase of barriers to entry as the consequence of the merger.[48] With low barriers to entry, the existing players cannot raise prices at their whim because of a risk of new entries, which may undercut prices and steal the market. Such analysis is purely effects-based and would not have been possible with a structure-based analysis of the old test.

[41] ibid para 125.
[42] Bishop (n 20) 360.
[43] *Siemens/VA Tech* (Case COMP/M3653) [2006] OJ L353/19.
[44] ibid para 16.
[45] Roller (n 7) 24.
[46] ibid.
[47] *Hutchison 3G UK/Telefónica UK* (Case M7612) [2016] OJ C357/15.
[48] ibid para 40.

E.ON/MOL[49] represents a challenge to a vertical merger. MOL was a supplier of wholesale gas to E.ON. The merger would not give E.ON "dominance" in downstream market, but would give it the ability and incentive to sell gas at a higher price to downstream competitors.[50] As such this is a clear "gap" case.

The first three decisions discussed are likely to represent examples of a "gap", while the fourth one is almost certainly demonstrates it. This means that the new test did appear in time to make a positive contribution to the merger analysis.

CONCLUSION

The 2004 revisions to the substantive test for competitive harm in the EU Merger Regulation, indeed, came not a moment too soon. The structure-based approach of the old test caused a "gap" in the analysis of the unilateral effects, which was "patched up" by the new effects-based system. By the time academics calls-for a move towards a new regime became loud, the existing regulation was over a decade old and all the disadvantages of the regime were well known. Therefore it is clear that the revisions could have been implemented in more timely fashion. However when revisions did come into effect,this affected analysis of several major decisions, which would have been, most likely, decided differently if the "dominance" test still applied.

The final point to make is that the 1989 MR came into existence fairly late in the history of the European Union. Knowing the failings of the structure-based approach in theory and in practice, demonstrated by other jurisdictions, it seems clear that the 1989 MR should have never contained a "dominance" test in the first place.

[49] *E.ON/MOL* (Case COMP/M3696) [2006] OJ L253/20.
[50] Roller (n 7) 25.

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