# European Merger Control: A Bulwark against the Rising Tide of Mergers?

At the start of February 1998 a merger was announced between the two British pharmaceutical companies Glaxo Welcome and SmithKline Beecham. Following the waves of corporate restructuring in the banking and insurance sector, energy supply, among telecommunications firms and media concerns, this mega-merger would have created the second largest concern in the world – in terms of its equity value of DM 370 billion – after General Motors (DM 415 billion). Although this merger was subsequently called off, mergers of a similar order of magnitude are certain to arise in the near future. In all probability they will not be opposed by the European Commission, any more than was the case with virtually all previous large-scale mergers. In the face of global markets, virtually any merger can be justified with reference to the size of competitors. The traditional approach taken by competition policy authorities, according to which mergers are only blocked where there is proof of market dominance, is therefore scarcely likely to serve as a bulwark against the rising tide of new mergers. While European industrial policy-makers tend to welcome the realignment of global players, proponents of a rigorous competition policy have warned of the implications of excessively large and powerful conglomerates, and have called for a reorientation of merger control, in particular for greater attention to be paid to considerations of efficiency.

## Historical background

The founding fathers of the European Community were aware that a policy of European integration that had set itself the target of removing tariff and other barriers to trade would require accompanying policy measures in the form of a rigorous competition policy. By this means, the creation of new barriers to competition in the form of market power and cartel formation between private companies was to be prevented, as these would have deprived consumers of the fruits of trade liberalisation. Responsibility for competition policy in the Community is borne by Directorate General IV (DG IV). Its task is to prevent the abuse of market power by private companies and collusion between firms that poses a threat to competition; it must also ensure that no illegal state aid that might block or even reverse the process of integration is granted, and it also monitors publicly owned or sanctioned monopolies. What it lacked for many years was the means to exert a prophylactic control on mergers at supranational – i.e. European – level.

This gap in European competition legislation was closed in 1989 with the introduction of the Merger Regulation,[1] just in time for the completion of the European Single Market: Articles 85 and 86 of the EC Treaty, which provided merely for a ban on horizontal and vertical collusion and the abuse of market power, had proved to be largely impractical for controlling mergers. The Merger Regulation came into force on 21 September 1990.[2]

## The Merger Regulation – a compromise

The very fact that the Regulation was passed at all must be seen as a major success for European integration, given the task of reducing the principles of competition policy operating in 12 Member States to a common formula. Its aim was to prevent mergers that posed a threat to competition and to help maintain competitive market structures in Europe. Whereas in the USA the prime motivation behind the introduction of anti-trust policies was democratic control over economic power, the driving force in the case of European legislation was the idea of integration, i.e. the political desire to create a common market. Competition policy-makers were consequently sceptical from the outset as to whether the Merger Regulation would meet the stiff demands made of it, and whether it would prove possible to shield it from the influence of industrial policy.[3] Such scepticism was based, among other things, on a formulation in Article 2 (1) b of the Regulation whereby when examining whether a merger can be reconciled with the common market the Commission must take into account "*technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to*

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[1] 15. Council Regulation (EEC) No. 4064/89 on the control of concentrations between undertakings (OJ no. L395/1), abbreviated here as "Merger Regulation" or "Regulation".

[2] The Merger Regulation also served to simplify large-scale cross-border fusions affecting the Community as a whole. The principle of the "one-stop shop" meant that time and money could be saved for firms wishing to merge across borders by avoiding the necessity of multiple procedures, and raised legal certainty by ensuing uniform treatment and avoiding discrimination.

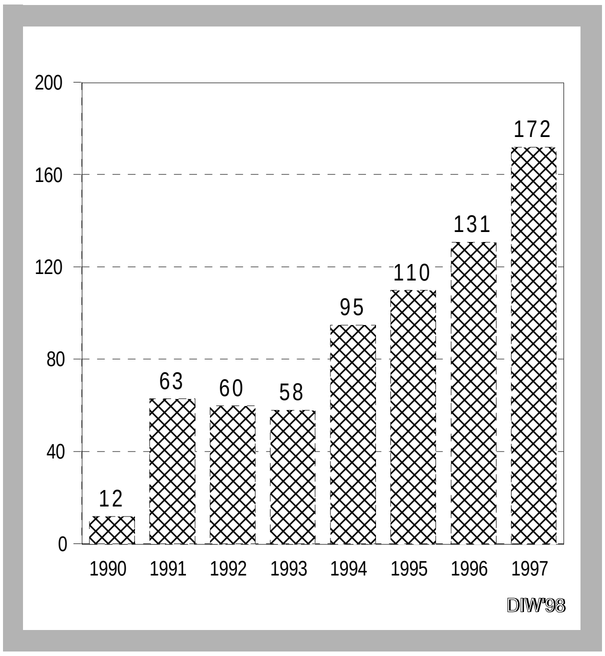
[3] See, among others, C. Jones and E. González-Diaz: The EEC Merger Regulation, London 1992, and D. Neven, R. Nuttall and P. Seabright:Merger in Daylight: The Economics and Politics of European Merger Control, London 1993.

*competition*". This so-called "French Clause", which permits the maintenance and development of effective competition to be weighed against technical progress, provoked fears among competition policy-makers that merger control might be abused for structural and industrial policy ends.

## European merger control in practice

During the seven years in which European merger control has been exercised, a total of 701 mergers (as of the end of December 1997) were referred to the Commission, in the majority of cases involving joint undertakings. Initially there were about 60 referrals each year, but after 1993 the figure rose rapidly (cf. figure 1). To some extent this was due to purely formal factors. For a merger to come under the provisions of the Merger Regulation, the combined aggregate worldwide turnover of all the undertakings concerned must be more than ECU 5 billion and the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than ECU 250 million. Thus both the real and the nominal (i.e. due to inflation) increase in corporate turnover has led to a de facto reduction in the threshold values. The number of referrals has also increased because of the efforts made by the Commission to extend the material field of application of the Merger Regulation with regard to joint undertakings. The other reason lies in corporate strategy. It seems clear, not least from recent reports of international mergers, that the world's leading corporations are currently seeking realignment along the lines of "bigger is better".

Figure 1
Notifications Under the Merger Regulation




Source: European Commission, DG IV.

The main procedure (Phase 2) has been opened in 40 cases so far. Of these, 9 mergers were approved unconditionally and 23 subject to various conditions; only 8 planned mergers have been prohibited entirely. In the vast majority of cases (531) the European Commission had no objections.

Despite the sharp increase in the number of cases referred – the extension of the Community to incorporate three new Member States has also increased the number of cases – the Commission has managed to process every single application on time, and generally to the satisfaction of the industry. In these terms European merger control can be seen as a success. Yet there are a growing number of voices calling for a more restrictive and consistent application of the procedures, and who criticise the influence exerted by industry and politics that has been observed at various times.

The Merger Regulation broke new ground in competition policy. Although the wording of Article 2 clearly betrays the handwriting of German competition policy-makers, unlike in German legislation there is no presumption of market dominance; in other words, the Regulation does not set out figures for market shares that, if they are exceeded, lead to a presumption of market dominance. To put it another way, substantial market shares are not a sufficient condition for market control. Rather, in the Regulation what is important is the current and potential state of competition and whether market entry can be expected in the future. This means that a prognosis of the behaviour of the companies involved in the future is required in order to justify a prohibition. This certainly does not make the task of the European Commission any easier, but it does give it significant scope for discretion.

The criticism regularly made of decisions by the Commission has in many cases come down to differences in the evaluation of future trends on individual markets. In contrast to the German Bundeskartellamt (Federal Cartel Office), for example, the Commission has increasingly incorporated the consequences of the Single European Market into the basis for its decisions. The Commission has frequently based its decision on the assumption that the European Single Market would serve to open up national markets. This can be justified to the extent that future developments on European markets are determined to a large degree by the gradual realisation of the Single Market, and this must therefore be taken into account when analysing the implications of a merger for competition. In a number of cases the global market was considered to be the relevant market; examples include Aérospatiale/Alenia/de Havilland or Boeing/McDonnell Douglas. These differences in evaluation were exacerbated by the fact that the Commission took a specific line regarding the definition of the relevant product and geographical market. Thus from the very outset, the definition of the relevant market has constituted one of the main problems of European merger control in practice.

## Evaluation in terms of competition policy

The Commission's decisions have been repeatedly criticised for their lack of a systematic approach and their inconsistency. In contrast to, say, American anti-trust proceedings, there is no formalised framework that reduces the uncertainty – not least for the actors involved – surrounding the outcome. The only aspect in which the European Commission has been consistent is in its optimistic view of competition on the European market and its stubborn refusal to recognise national specificities.

By taking into account – more or less systematically – additional factors beyond national or European market shares in its decisions, the European Commission's proceedings have at times taken on an ad hoc character. The evaluation of whether the merged company held a dominant market position, the estimation of current and potential competition or the determination of buyer power have tended to be based less on systematic market definitions – such as set out in the Merger Guidelines in American anti-trust operations – than on ad hoc prognoses and subjective evaluations by the Commission.[4]

The commitments and conditions negotiated by the Commission with merging firms are also largely unsystematic, and it is difficult to determine their impact in the future on competition. This applies particularly in the case of commitments and conditions that relate to the subsequent behaviour of the parties concerned, and which are therefore very difficult to monitor over time.[5]

The role of the Commission as "policeman, prosecutor, judge and jury all rolled into one"[6] gives it a wide range of powers in the area of merger control; in the final analysis it is free to decide whether to judge a case itself or, on application, to delegate it to a Member State (cf. figure 2). If it decides – in the face of an application for referral to national authorities – to deal with the case itself, it may, if it has serious reservations, open up the main proceedings (Phase 2) or grant approval within one month (Phase 1). In order to underline the exceptional nature of applications for referral to national authorities under Article 9 (2), the Commission has so far been very reluctant to grant such applications. This has given rise to repeated criticism.

The scope for discretion during the various phases of the merger control proceedings is often exploited by lobbyists and interest groups seeking to exert an influence on the Commission's decisions. The consequence has been a toleration of market dominance in the case of firms with a strong national or regional power base.

As late as 1991, Sir Leon Brittan claimed that "... the stable foundations of the policy have helped us to avoid the politicisation of decisions ...";[7] at the same time he warned that "(w)e must resist the temptation to warp competition policy for the sake of imagined gains on other fronts".[8] Developments since have shown this view to have been excessively optimistic: influences not related to competition-policy considerations were clearly at work in a number of decisions taken by the Commission since then; examples include Alcatel/AEG-Kabel, Nestlé/Perrier, Kali & Salz/MdK/Treuhand, and Mercedes-Benz/Kässbohrer.

A serious weakness of European merger control lies in the voting procedure used to take decisions. As in other cases, the Commission as a whole – currently 20 Commissioners – votes on each decision. The Competition Commissioner recommends a decision to the Commission. The other Commissioners are not bound by this recommendation, however. The Competition Commissioner has only one vote, along with all the others, so that his recommendation can be voted down.[9] In order to avoid such an eventuality – which is damaging to prestige – the Merger Task Force always seeks to determine from the outset the likely majorities on the Commission. Wolfgang Kartte, former President of Germany's Federal Cartel Office, considered this "inborn"

[4] This was apparent in the decision to approve the merger between the Community firms Varta and Bosch. In this case the combined market share of 44% was not considered by the Commission as indicating market power. It was assumed that the two remaining competitors, Fiat and Deta/Mareg (each with a market share of around 10%) constituted effective competition for the market leader. Fiat, which previously - via the merger between Magneti Marelli and CEAc - had acquired CEAc (with a 2-5% share of the German market) and Sonnenschein (between 5 and 10% of the German market), was able to expand its share of the German market from 1% to 10%. Fiat's access to a distribution network for a brand-name product plus its financial resources convinced the Commission that the competitive potential of the newly created competitor to Varta/Bosch was greater than that suggested by the current market share of around 10%.

[5] A good example here are the conditions imposed on Nestlé/Perrier and Du Pont/ICI.

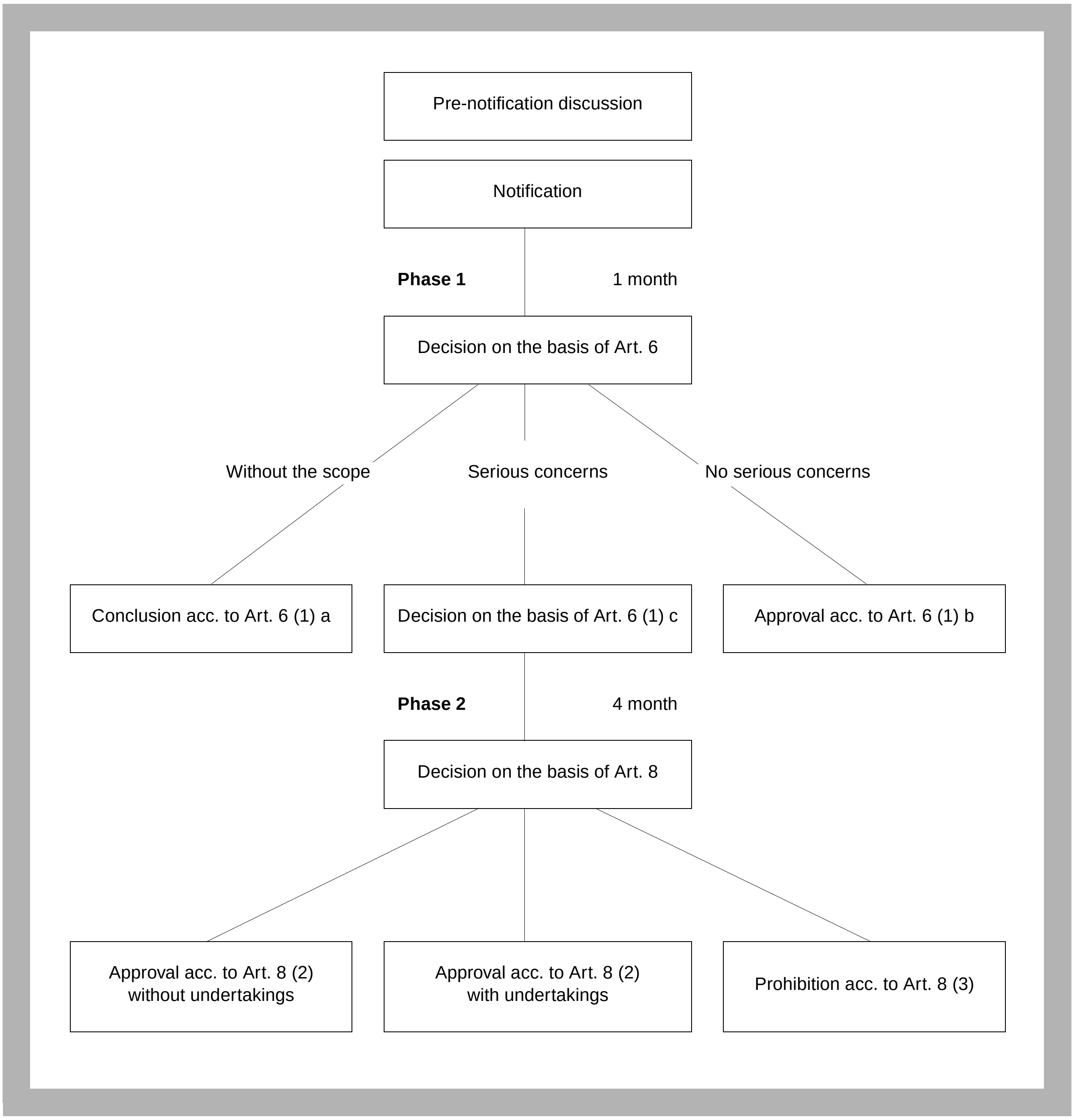
[6] L. Brittan: European Competition Policy, London 1992, p. 11.

[7] Op. cit. p. 4.

[8] Op. cit. p. 8.

Figure 2

European Merger Control Procedure




Source: Taken from G. Drauz and D. Schröder, Praxis der Europäischen Fusionskontrolle, Cologne 1992, p. 114; own translation.

weakness of European merger control to be a built-in guarantee of a permanent politicisation of decision-making in critical merger cases.

Practical experience of European merger control allows the conclusion to be drawn that the European Commission does not in all cases take seriously the task of maintaining competitive structures in Europe and protecting consumers. The efforts made by the Commission to place the in-some-cases very lengthy proceedings under Article 85 of the EC Treaty under the auspices of the Merger Regulation by means of appropriate directives and interpretations of legislative provisions are

[9] In the case of Mannesmann/Vallourec/Ilva the Competition Commissioner was outvoted in the (then) 17-member Commission, and was unable to obtain a majority for his recommendation that the merger be banned. In consequence, the written justifications had to be "adjusted" to make them congruent with the vote by the Commission.

also to be seen in this context. For understandable reasons, this has met with the approval of industry, which has itself sought to ensure that wherever possible it comes under the provisions of the Merger Regulation, by structuring its mergers or joint undertakings accordingly. This would enable the Commission to reduce its work load and to reduce the number of cases pending under Articles 85 and 86 of the EC Treaty. Quite apart from the fact that this implies a further increase in the number of cases dealt with by the Merger Task Force,[10] so that the quality of the decisions taken can only be maintained if additional staff are recruited, this very loose interpretation of the Merger Regulation can scarcely be equated with objective circumstances.

Since 1990 there have been no spectacular merger bans, with the sole exception of Aérospatiale/Alenia/de Havilland. While it may be that European merger control works normally in standard cases, its weaknesses in "prominent" cases are all too apparent.[11] Given that both the French and Italian governments had put their weight behind the Aérospatiale/Alenia/de Havilland fusion, the fact that it was prohibited was, from today's perspective, a sensation. It is almost certain, though, that the vote was taken in the wake of a political deal.[12]

## Calls for reform

In Germany, merger control is characterised by a separation between "competitive" and "political" evaluation. The Federal Cartel Office decides exclusively on the basis of whether a merger is acceptable with respect to competitive aspects. The Economics Minister can, under § 24 (3) of the Act against Restraints of Competition (Gesetz gegen Wettbewerbsbeschränkungen, GWB) approve a merger that the Federal Cartel Office has banned, if this is seen to be for the common good. Before this can happen, a report must be sought from the Monopolies Commission; the Minister is not bound by its recommendations, however. The reports of both the Federal Cartel Office and the Monopolies Commission are published. This forces decisionmakers to justify their decisions in public.

This tried and tested division of labour does not exist in European merger control, which is a one-stage procedure. A merger control system in which the political element makes its effect felt beyond the public gaze, and before the relevant facts and legal criteria have been determined, is susceptible to political influence. This means that the reasons for which a merger has been allowed remain unclear.[13] In order to shed light into this matter at European level, it has been proposed that the competition-policy evaluation by DG IV should be published prior to the decision by the Commission. This would not restrict the formal powers of the Commission, but would raise the pressure on it to justify its decisions.

Other reform proposals, such as the creation of an independent European Cartel Office on the model of the German Bundeskartellamt,[14] appear neither practical at present nor to constitute a solution to current problems.

At the start of 1996 the European Commission presented a Green Paper on a revision of the Merger Regulation. In it the Commission analysed the way in which the Regulation had functioned and made proposals for improvements. In April 1997 the Council of European Industry Ministers reached agreement in principle on a revision of the Regulation. The changes agreed were marginal in nature, however. The threshold values were not reduced as the Commission had demanded back in 1993. This would have meant that even more mergers than previously would have come under European merger control. The German and British governments voted against – with reference to the additional burden this would have placed on the Commission. Thus for the foreseeable future there will be no fundamental changes in the system of European merger control along the lines proposed by the Commission in its Green Paper. The task of bringing about a more efficient structure has thus been postponed indefinitely.

It is evident – and the statements made by the competition policymakers responsible confirm this – that in the final analysis the Commission's primary concern is the greater goal of European integration. It seems that it assumes that the goals of integration and competition cannot always be reconciled, and that in the case of goal conflict, competition policy must play a subordinate

[10] Originally between 50 and 60 cases a year were expected. The number of cases referred has since virtually trebled, however (cf. figure 1).

[11] According to D. G. Goyer (EC Competition Law, 2nd edition, Oxford 1992, p. 508) 'The machinery established by the regulation, while working well for the uncontentious case, has important potential weaknesses in the handling of major cases.'

[12] G. Ross: Jacques Delors and European Integration, Cambridge 1995, p. 130ff. 'Manuel Marin, the swing vote, gave an utterly incomprehensible argument to explain himself, but seemed to have traded his vote for help from Brittan on a pending project to reorganise the European fishing fleet, an essential Spanish dossier.'

[13] This is the central strength of the German, French or British systems "which in their different ways ensure that the 'legal' and 'political' stage are kept separate, and that any final decision to permit a merger on political or social grounds is transparently seen as such, and is not confusingly presented as the 'legal' outcome of the case." (D. G. Goyder, op. cit. p. 509).

[14] See, for example, M. Bishop: European or National? The Community's New Merger Regulation, in: M. Bishop and J. Kay: European Mergers and Merger Policy, Oxford 1993, p. 313.

role.[15] In contrast, the former protagonists of European competition policy primarily pursued the aim of preventing the accumulation of market power and maintaining efficient market structures.[16]

It is highly doubtful whether – in the face of the rising tide of mergers – it will prove possible to maintain efficient market structures using the current system of European merger control. As a whole series of empirical studies of mergers has shown,[17] only a small proportion of mergers is successful in business terms and leads to improved efficiency (e.g. lower costs). Particularly problematic are so-called conglomerate or diversification mergers.

## Conclusion

In view of the rising tide of mergers, the question of how to establish an effective European merger control system is an urgent one. If competition policy is to be maintained along the lines set out by its former protagonists, a policy of rigorous merger control finally needs to be seriously addressed. A weak hand in this matter, one that allows – if not actually encourages – firms, with the aim of European integration in mind, to merge across international borders and thus become global players, permits them to achieve through the back door (i.e. through merging) what they were clearly unable to do through internal growth. If Europe is to avoid a wave of mergers such as hit the USA at the end of the last century, macroeconomically damaging mergers must be prevented from occurring. Even if the balance of power within the Commission does not justify expectations of significant changes, a U-turn in the way merger control is being performed is an urgent requirement from an economic perspective. It is all too apparent that, at the end of the day, the European Merger Regulation was a political compromise: this is reflected both in its provisions and in its mode of implementation. Yet this must not be allowed to let European merger control degenerate into an "integration machine".

Current developments constitute a challenge to European competition policy, and at the same time raise questions concerning the competition-policy model that Europe intends to follow. Business requires an orientation-giving framework, one that makes it clear which mergers the European Commission is prepared to tolerate, and where it is willing to put a stop to them. A plausible way forward would be to draw up directives along the lines of the American Merger Guidelines. In addition, strict maximum values (turnover, balance sheet totals, etc.) for mergers need to be imposed. If these maximum values are exceeded, the onus would be on the firms seeking to merge to show that such a step would be macroeconomically beneficial, i.e. would raise efficiency. In order to ensure the sustainability of these efficiency gains, this proof would have to be provided over an extended period (say ten years).[18] This would ensure that the negative effects – greater concentration and market power – would be compensated by higher efficiency. A policy that encourages firms, with a view to the global market, to join together to form "European Champions" leaves scarcely any scope at all for European competition policy.

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[15] In the words of the current Competition Commissioner, Karel Van Miert, competition policy "is not an end in itself to be pursued dogmatically; it is an instrument, albeit an important one, for achieving agreed Community objectives – economic integration, cohesion, improved standards of living, sustainable growth, social welfare and protection of the environment."

[16] (L. Brittan, op. cit. p. 21) 'Consumers and companies are best served by competitive pressure leading to innovation and efficiency, not by dominance.'

[17] See, for example, D. C. Mueller: The Determinants and Effects of Mergers: An International Comparison, Cambridge, Mass., 1980; D. Ravenscraft and F. . Scherer: Mergers, Sell-offs and Economic Efficiency, Washington D.C., 1987; D. C. Mueller: Antimerger Policy, p. 237 ff.

[18] D. C. Mueller: Antimerger Policy, op. cit. p. 245 ff.