Response of the Irish Delegation to the Merger Green Paper

INTRODUCTION

Ireland welcomes the Green Paper on reform of the Merger Regulation and is pleased to respond. The response focuses on what we believe to be the most salient areas.

JURISDICTIONAL ISSUES

Article 1(3)

The Irish delegation considers that Article 1(3) has not been entirely successful in its aims. However, an automatic competence for the Commission in the case of filings in three or more Member States seems perhaps too draconian a measure at this point. Some merger cases may meet this criterion merely through technical notifications in, say, two of the Member States, while the bulk of the involvement would be within just one State. In this kind of situation, an automatic referral to the Commission does not seem warranted.

There is also a problem of consistency. Merger notification thresholds under domestic competition law vary widely. It would seem invidious to require referral of cases which meet the domestic thresholds in three or more Member States, while other mergers, which may actually involve companies with a higher aggregate turnover and a higher cumulative share of the market within the EU, would escape such scrutiny because of inconsistencies among the various market share thresholds applied in different Member States. It might be argued that the member state thresholds could be harmonised, but this has been put forward as a reason for dismissing the possible modification of Article 22 as an alternative.

The recent referral by a number of Member States of cases under Article 22 may provide a viable alternative, and a final decision on 1(3) should only be taken after assessing the effectiveness of this procedure.

Article 9

The Irish delegation supports the simpler criteria for referring a case under Article 9, as laid out in paragraph 81(a) of the Green Paper. In such a situation it could possibly countenance the shortening of the time period from three weeks to two, though it accepts that the sometimes complicated decision-making process in some Member States may result in practical difficulties with this new time limit, and thus suggests the Commission only adopt this if each Member State feels it is an enforceable limit.

SUBSTANTIVE ISSUES

The Substantive Test

The Irish delegation favours the substantial lessening of competition (competition) test over the dominance test. We concur with the view expressed in the Green Paper that both tests can give rise to similar outcomes in the vast majority of cases. Indeed, this congruence of both tests enabled Ireland to adopt the competition test in new legislation enacted in April 2002. However, we consider that the competition test has several advantages over the dominance test and, importantly, that there exists a set of mergers that should be prohibited because they restrict competition, but that are difficult, if not impossible, to characterise in terms of dominance.

The current ECMR test combines both a dominance test and a competition test: "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 central position of the dominance component in the existing EU test has been enormously successful and enjoys confidence. It has proved to be a flexible test, and the development of the concept of collective dominance, reinforced by ECJ judgements, has enabled the test to deal with types of merger in oligopolistic markets, particularly those where collusion or joint profit maximisation may be enhanced. The EU dominance test has enabled meaningful convergence of substantive standards with jurisdictions like the US that use the competition test.[1] Over the past 12 years, a body of precedent has developed and been widely accepted, and some clear bright-line rules for business have been established. During this period, several member states, presumably influenced by

[1] For example, the recent different decision in the GE-Honeywell case did not rely on the different tests in the US and the EU.

the above points no less than by the desire to promote integration of standards within the EU, have changed their test to the dominance standard.

For these reasons, many believe that, even if the competition test has some marginal advantages over the dominance test, it is not appropriate to make a change. This view has two elements. One is summarised in the expression: “If it ain’t broke, don’t fix it”. Another element is that the costs of switching to the competition test are far exceeded by any possible benefits. In essence, it is not the inherent worth of the dominance test but rather its 12-year *status quo* that is the main barrier to change.

The Irish delegation strongly favours the competition test, and believes that the change in test is very much worth making. The basis for this is our belief that there exist two categories of anticompetitive merger in oligopolistic markets that cannot be controlled within the existing collective dominance label. One is the merger of two firms that produce differentiated or branded products that are close substitutes within a broader relevant market, and where the post-merger market share is below the level for dominance (say 40%), but competition is reduced because the brands are close substitutes within the relevant market.[2] The other is where firms compete in output or capacities, often for a relatively homogenous product, and again in a situation where the post-merger market share is below the level for dominance[3]. Such mergers are often described as “unilateral effects” because welfare is reduced by a change in the competitive Nash equilibrium in which the merged firm will raise price unilaterally.

From both economic and legal perspectives, such mergers are different than those in which the merger increases the probability that the parties will collude. They will appear similar in that the merger may make an already concentrated market more concentrated. However, they are fundamentally different in that collusion is about moving from a competitive to an uncompetitive equilibrium, whereas unilateral effects mergers are about a change in a competitive equilibrium. Because the cases are not mutually exclusive, it is possible that some cases (and Airtours may prove to be an excellent example) where

[2] An example might be the US Babyfoods case. See *FTC vs H.J. Heinz Company*, 2001, www.ftc.gov/os/caselist/ca100cv01688ddc.htm This case involved the merger of two firms with 15% each of the market, where the other 70% was held by one firm. The merger was considered to substantially lessen competition between the two smaller firms in the market. It could have been difficult, on the fact of this case, to characterise it as collective dominance in the sense of EU legal precedent.

[3] One reading of the Airtours decision of the Commission, currently on appeal, is consistent with this characterisation.

there is a unilateral effect but where the market facts also support a finding that collusion would be more likely after the merger will see an overlap of the two effects. Indeed, this overlap is more likely the smaller the number of firms, which may mean that the existing case law, which largely addresses the situation of 3 going to 2, has not yet encountered the problem fully.

The problem, as we see it, is that the concept of collective dominance that has developed over the past 12 years encompasses clearly the collusive case, but not yet the cases where the competitive equilibrium changes. If the EU is to be able to control unilateral effects mergers properly, then two solutions to this problem exist: switching test, or trying to accommodate unilateral effects within the dominance test. Accommodation within the collective dominance test may be possible and, again, Airtours may be illustrative of this for the quantity competition case. Even if this happens, however, we will be left with several types of collective dominance, and it may not be clear which standard applies. Accommodation of the differentiated case is more likely to succeed via excessively narrow market definition: that is, to define the market narrowly so as to include just the merging parties. This leaves problems later, as narrow market definition decisions in previous cases will be exculpatory in future ones.   In other words, if the market is defined too narrowly so that other meaningful competitors are excluded, then later mergers between one of the original merging parties and one of the “outside” competing firms would not increase concentration as they could be deemed, by precedent, to be in different relevant markets. This would also pose problems for the Commission notice on Market Definition.

The argument for changing test will become more compelling if, over time, it becomes apparent that the ECJ will not be prepared to extend the concept of collective dominance to unilateral effects cases.   On the other hand, if unilateral cases do get forced into the category of collective dominance, the distortion and stretching of this term may create considerable legal uncertainty.

The Irish delegation considers that this is the single most compelling argument for a switch in the test, and that allowing the EU agency the flexibility to examine unilateral effects mergers in an open and transparent way, rather that shrouding them under an ever-expanding concept of collective dominance, far outweighs the once-off costs of switching. There are a number of additional points to be made in favour of the switch.

First, switching to the competition test would enable a de-coupling of the concept of dominance in Article 82 from the Merger Regulation test. *Ex ante* merger control requires a fundamentally different standard and approach than *ex post* analysis under Article 82. This works both ways: the high standard established in Article 82 cases should not be an unnecessary constraint on ECMR analysis; and the case law developed under the ECMR, if subject to a different standard, should not inadvertently creep into Article 82 cases. While this is self-evident for single firm dominance, it raises even more profound concerns for collective dominance, especially if that concept were to be expanded to deal with unilateral effects. This could be become increasingly important after structural remedies are introduced in the proposed revision of Regulation 17.

Second, we do not believe the costs of switching are so great. The two main categories of case, monopoly and collusion, are the areas where the substantial convergence already obtains. The change in test should have no effect here, and the existing precedent for both single-firm dominance and collusive mergers would continue to be valid under a competition test. So, the greatest economic cost, in terms of increasing uncertainty for business, is likely to be extremely low. Such costs that might exist could be substantially reduced by clear guidelines in advance.

Third, the two EU Member States, Ireland and the UK, who have most recently examined the question of which test to use in the context of reform of domestic legislation have opted for the competition test.[4] Both countries reached this decision independently. In Ireland's case, the choice was based in large part on the arguments outlined in this paper, but also on the extremely positive experiences of other countries such as Canada and Australia that have adopted a competition test. Other member states such as France and Spain appear to operate what is, in effect, a competition test and have not changed this in recent legislation. For these reasons, it is arguable that only the competition test will enable long-term convergence to the same test within the EU Member States.

Fourth, the competition test has an intuitively obvious or natural appeal. From an economics viewpoint, the creation or strengthening of a dominant position is a subset of restrictions on competition. This fundamental economic point is recognised legally in the fact that we have both Article 81 and Article 82. Indeed, this means that the EU is not

[4] In Ireland's case, the test is now law, and will come into effect shortly. The UK legislation is before its Parliament.

limited to basing its test on Article 82, but can adopt the broader test. It seems appropriate that merger control should use the test that encompasses all restrictions on competition, rather than just a subset, and the competition test does exactly this.

Because the competition test is broader and could enable greater control of all mergers in oligopolistic markets, clear guidance would be necessary. Many mergers in oligopolistic markets do not increase market power. Some mergers in oligopolistic markets are driven by intensive price rivalry, which leads firms to seek efficiencies via merger, and these mergers may even enhance competition. For these reasons, and in order to enhance the legal predictability of the test, it would be extremely desirable that guidelines be introduced on how the competition test would apply.

In summary in this section, the Irish delegation argues not simply that the competition test is preferable to the dominance test, but that there are compelling reasons to change the test at EU level. We acknowledge the enormous success of the dominance test over the last 12 years. Yet, we believe that there are important types of merger that reduce competition that cannot be brought easily within the dominance rule. Switching test would involve no substantive loss of precedent or case law in switching to another test, but rather would enable the desirable decoupling of Article 82 from the ECMR.

The Efficiency Defence

The Green Paper seems to us to be inherently correct in expressing scepticism about efficiencies arising from mergers.

- Empirical studies indicate that, on aggregate, the *ex post* performance of merged companies is, at best, mixed, suggesting that efficiencies may systematically fall below the parties' genuine expectations.

- From an economic theory perspective, there is a fundamental doubt about efficiencies in mergers where market power increases. If we believe that competition is fundamental to driving cost reductions, then efficiencies are less likely to be attained precisely in the case where a merger creates market power. Leibenstein's well-known idea of X-inefficiency seems particularly relevant here[5] – the biggest loss to aggregate welfare arising from substantial market power is not necessarily the standard loss of

[5] See H. Leibenstein, (1966), "Allocative Efficiency vs X-Efficiency", *American Economic Review*, 56. p392-415.

consumer surplus (substantive though that may be), but instead can accrue from high costs which are tolerated simply because the firm has no substantial competition which will force it to reduce costs and generate efficiency improvements. In this sense, the standard static economic analysis of merger efficiencies does not adequately reflect the dynamic interaction between rivalry and cost reduction.

- It is not always obvious that a merger (involving market power) is necessary to achieve many efficiency benefits.

- If an efficiency defence is allowed, then firms will have a strong incentive to exaggerate the efficiencies and it can be extremely difficult for a competition authority to verify them in advance. For this reason, the burden should likely lie on the parties to show the efficiencies, and a high standard of proof should be required.

Thus, while we endorse a broadly sceptical line towards efficiencies, we do not believe that an efficiency defence should be ruled out.

A useful rule on efficiencies defences might be a "net price" rule. If, as a result of the merger, the net price in the market will fall (and output expand correspondingly), then the merger could be permitted. Such a test might be difficult in practice, but is still conceptually useful. This would almost certainly not allow efficiencies to be taken into account where the merger creates a dominant position for a single firm, because of the absence *ex post* of the price rivalry that would deliver the efficiencies. However, an efficiency defence might be more palatable for mergers that substantially lessen competition but do not create dominance. If, after such a merger, there remains in the market sufficient price rivalry to give incentives to reduce costs and deliver efficiencies, then the net price test could be passed. For this reason, we believe that the question of efficiencies is not unrelated to the distinction between the competition and dominance tests.

In all of this, the burden should clearly be on the parties to prove the efficiencies. Moreover, standard cost savings such as moving to a single central administration should not be counted as efficiencies. Instead, cost saving should relate to real and demonstrable (i.e., not speculative) changes in productive efficiency that are merger-specific (i.e., could not be obtained from a less restrictive contract).

Certainly treating efficiencies as an offence should not occur. Where a merger increases efficiency, it is likely that this will increase competitive pressure on rivals. This should be seen generally as a positive move, encouraging rivals to improve efficiency. Absent the application of sound theories of foreclosure, that can be calibrated with a high degree of certainty, efficiencies that disadvantage competitors should not be used to prohibit a merger. Ultimately it is inappropriate to prohibit mergers simply because, by improving efficiency, they make life more tough for the competitors or even that it may risk competitors going out of business at a later stage. The appropriate presumption here, unless clearly challenged by the facts, is that rivals to an efficiency enhancing merger will have greater incentives to improve efficiency, bringing benefits of increased competition to consumers.

DUE PROCESS

The Green Paper raises a number of interesting issues about due process in merger cases. Concern has been expressed in the past about the role of the Commission in both investigating and determining mergers. Some argue that these roles should be separate, as they are in the United States where merger is treated as an enforcement process before the courts. We do not consider that the institutional arrangements in Europe are such at this stage that proposals of this kind are meaningful, nor that the current system has failed in such a substantive way as to justify wholesale institutional reform of this kind. Indeed, we accept that there are many useful checks and balances within the current system to safeguard the interests of the parties. We also note the inherent incentive for parties whose mergers have been prohibited, and others representing them, to complain about the system and to exaggerate claims that it operates contrary to natural justice.

At the same time, the fact that appeals of Commission decisions take such a long time, not itself of the Commission's choice, can add to the concerns about the multi-faceted role the Commission players. In order to allay such concerns, and in order to continue the process of improvement of policy that DG Competition has initiated in many areas, we suggest that some marginal reform in existing procedure may be worthy of consideration. We do not consider that all of these suggestions should be implemented at once, but rather wish to promote discussion of modest and incremental reforms within the current institutional framework.

1 **Greater use of the Advisory Committee.** The Advisory Committee has considerable potential to act as a more useful part of the process in merger decisions. Many members of this committee feel that its role at present is extremely limited, and that the Commission has, in part due to time commitments, created a hermetic seal about the decision-making process. Its role could be enhanced in some or all of the following ways.

a) Greater involvement at Stage 1, especially when commitments are offered by the parties, in an attempt to avoid going into Stage 2. While time is crucial at this point, the dissemination of information about offered commitments could be improved. The Network of Competition Authorities, which is proposed under the Modernisation regulation, could greatly facilitate the exchange of information without adding an unnecessary layer of bureaucracy.

b) A more active role for the advisory committee throughout Stage 2, but particularly during any Oral Hearings.

c) Getting papers, documentation and advance notice of meetings to Member States in sufficient time for them to consider them meaningfully. There is considerable variation in current practice, and in some cases, the ability of the members of the advisory committee to examine proposals is seriously limited.

d) Greater use of one member state as an independent rapporteur within the process. This could include earlier identification of the rapporteur and greater involvement within the process, and choice of rapporteur by the Advisory Committee itself.

e) Greater focus within the advisory committee membership on national representatives who are experts in competition, rather than experts in the particular industry policy.

2 **Strengthening the involvement of economic analysis within the merger process.** An increasing number of cases involve sophisticated and technical economic analysis being used, both by the Commission and by the parties. In some recent cases, most notably the GE / Honeywell and the Volvo / Scania cases, the outcome hinged in large part on the legal interpretation of such economic analysis. While the merger team may involve internal case officers whose original training was

in economics or external (often academic) economists, there would be considerable merit in strengthening and formalising the use of rigorous economic skill by the establishment of a strong independent economics unit within DG Competition. This unit could supply economists to work within a team on large merger cases, but the reporting structure would be via the head of this economics unit. For the system to work, this head of the economics unit would need to be established as a senior post and staffed with sufficient PhD economists to service and participate in not just merger teams, but also Article 81 and 82 teams. The head of the unit would need to be an eminent economist with expertise in the area of industrial organisation. For merger cases, the greatest advantage would arise where the head of the economics unit reported to the Director General independently from the MTF, but on the same informed base arising from the close teamwork of the officers from the MTF and the economics unit. Such a development would strengthen internally the rigour used in Commission arguments, especially when speculative economic theories are presented by parties as evidence for or against a merger. We consider a development along these lines to be of considerable importance for the future success of DG Competition's work generally.

3 **A more rapid appeal process.** While Commission merger prohibitions are frequently appealed to the ECJ, the delay involved in obtaining a judgement usually implies that any practical chance of consummating the merger disappears when the Commission decided to prohibit. Indeed, it could be argued that the Commission itself is disadvantaged by the fact that appeals take such a long period, as the intervening legal uncertainty may affect how it analyses other similar cases. Enabling a more rapid appeal is not a trivial matter, given the current constitution of the courts. One option is to have a specialist three-person chamber of the CFI just to consider appeals on competition decisions, not unlike the Competition Commission in the UK.

4 **Strengthen the role of the Hearing Officer.** The Hearing Officer could be made more independent from DG Competition, for example, by reporting to the President of the Commission, and be allowed to report on substantive as well as procedural issues. A strong and independent (from DG Competition) hearing officer would contribute to greater confidence in the process generally. It is extremely difficult for a hearing officer, or for a devil's advocate, to be fully effective and independent if

that person's career development and reporting structure lies within DG Competition.

5 **The Regulation should state clearly that that consumer interests are paramount.** Some complain, unfairly in our view, that the Commission puts weight on the complaints of competitors. A merger that increases competition damages competitors, and conversely anticompetitive mergers tend to benefit competitors. Because competitors' interests are opposite to those of consumers, it is appropriate that no weight be put on the complaints or interests of competitors in merger analysis. At the same time, it is important and proper to gather information from all market participants so as to understand better the details of the market and the strategies of firms in the market. Our understanding is that this is the current practice for the analysis of mergers by the Commission. Stating this in the regulation would merely involve an explicit and formal recognition of current practice, and also protect the Commission from unjustified and unfair criticism.

Simplified Procedure:

The Irish delegation generally supports the simplified procedure as outlined in the Green Paper.