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at the RBB/FIPRA seminar

"The future shape of European merger control"

Cercle Royal Gaulois

Brussels - 17/02/2003

Introduction

- Ladies and gentlemen, ... It is a real pleasure for me to be here today. It goes without saying that the subject of today's seminar is clearly one of my favourites. But also the occasion appeals a lot to me. The seminar is organised by two remarkable organizations. RBB, a new bright star in the galaxy of economic consultancy firms, and FIPRA, a reknowned think tank and public affairs company in the field of competition policy with a presence across the world.

- It doesn't come very much as a surprise to me that these two companies have joined forces to organise this seminar. Today's seminar is about the future shape of European merger control. I think that what makes the current merger review process special is that it has both an important public policy angle to it and an important economics angle. It will be most interesting to learn your views as to how successfully (or unsuccessfully ...) we are doing so far.

- Let me introduce this seminar by giving a brief recap of the main ingredients of the reform package. Looking at the audience, I may not have to spend too much time on this, but it is useful to keep the broader perspective. Also, you may be interested to hear more about our plans to improve the decision making process and to strengthen the economic capabilities of DG Competition. Then I would like to turn to what is maybe the focus of today's discussions, the proposals for the substantive test for merger control, and the Draft Notice on Horizontal Mergers.

A brief recap

- As you know, the Commission adopted, December last, a comprehensive reform of the EC system of merger control, as laid down in the EC Merger Regulation. The aim of this package of reform is to build on what is generally regarded as a successful record, but to ensure that European merger control remains adapted to the economic realities of today and tomorrow (globalisation, enlargement of the EU).

- The reform package which the Commission has adopted consists of the following elements (i) a proposal to the Council for a new Merger Regulation; (ii) a draft

Commission Notice with guidance on the assessment of horizontal mergers; (iii) a draft set of best practices on the conduct of merger investigations. In addition, the Commission has outlined a number of measures relating to the staffing and internal working methods of DG Competition. The issues covered by these proposals are jurisdictional, procedural and substantive.

Some jurisdictional issues

- On the jurisdictional side, one of the main objectives of the review is to optimise the allocation of merger cases between the Commission and national competition authorities. Particular attention has been paid in this respect to the phenomenon of "multiple filing", i.e. notification to various competition authorities within the EU.

- Essentially, the Commission is proposing to simplify and render more flexible the Merger Regulation's provisions concerning referral of cases from the Commission to Member States and vice versa.

- For example, it is proposed that referral be made applicable at the pre-notification stage. If our proposals are adopted, the notifying parties can make a reasoned request for a pre-notification referral of the case in either direction. Such a request would have to be acceded to by both the Commission and the national competition authorities concerned.

- Further, if a minimum number of Member States agree to a case being referred to the Commission, the case would be deemed to fall under exclusive Community jurisdiction.

- There are many more things to be said about the jurisdictional aspects of our proposals, but I propose to leave it here for the moment. Let me turn to the procedural aspects.

Procedural issues

- In order to improve the quality of our decision-making, and at the same time enhance the involvement of merging companies during the course of an investigation, a series of measures not requiring legislative change are being taken. These measures will, I am confident, ensure that our merger investigations are conducted in a manner which is more thorough, more transparent, more focused, and more firmly grounded in sound economic reasoning.

- I am thinking of the formalisation of the existing peer review "panel" system in Phase 2 merger cases. A Panel composed of experienced officials would be appointed for all in-depth investigations, and would have the task of scrutinising the case team's conclusions with a "fresh pair of eyes" at key points of the enquiry. It is our intention that this Panel system should be deployed throughout the Directorate-General: Decision-making in the antitrust and State aid areas would, in our view, benefit equally from such an approach.

- Second, we think of a making more systematic use of so-called "State-of-Play" meetings between the Commission and the merging parties at decisive points in the procedure, thereby guaranteeing that the merging parties are kept constantly apprised of progress in the investigation, and given the opportunity to discuss the case with senior management.

- We anticipate enhancing access to the Commission's file, including an opportunity to fully review the Commission's file following the opening of an in-depth investigation, and the possibility for the merging parties to be given *ad hoc* access to third party submissions running counter to the merging parties' view of the market.

- As for the timetable, although we are firmly opposed to a general erosion of the tight timetable inherent in the current regime under the Merger Regulation, we do consider it important to introduce a degree of flexibility with regard to the timeframe for merger investigations, in particular in complex cases. To that end, it is proposed that an additional week be accorded to merging parties extending the time during which they may offer of commitments in Phase I, and an additional 3 weeks in Phase II. Beyond that, it is proposed that additional time (up to 4 weeks) could be added to Phase II, at the request of the merging parties, in order to allow for additional investigation time in complex cases.

Enhancing DG Competition's economic capabilities

- A major element of the package, and I am not sure whether I should call it procedural or substantive, is to enhance DG Competition's economic capabilities.

- In view of the increasing complexity and global scale of merger cases, it is clear that there is a need to improve DG Competition's staff resources dealing with merger cases, and in particular its economic capabilities. Accordingly, a new position of Chief Economist will be created within DG Competition, with the staff necessary to provide both an independent economic viewpoint to decision-makers at all levels, and to provide guidance throughout the investigation process. It goes without saying that the role of the Chief Economist would not be limited to his/her involvement in merger control, but would also extend to competition law enforcement generally, including the control of state aid.

- Let me say a few more words on this. The Chief Economist will report directly to the Director-General, that's me. His/her main tasks will be to give guidance on methodological issues of economics and econometrics both in the application of EU competition policy generally and in individual cases. He/she will give detailed guidance in the most important competition cases involving complex economic issues, in particular those requiring sophisticated quantitative analysis. Preferably this should take place from the early stages of the case. This could also include the secondment of a member of his or her staff to work in the case team. His or her final advice in individual cases will be made available both to the Commissioner for Competition and the College of Commissioners.

- The Chief Economist will have a dedicated staff of approximately 10 specialised economists, half of whom will be permanent officials and the rest comprising temporary officials who have yet to be recruited. The Chief Economist and his or her staff will interact as appropriate with the other staff of the DG Competition, in particular with those with economic expertise.

- The Commission is in particular seeking an economist who, in addition to his/her basic training, has specialised in industrial organisation and has had practical experience of the analysis of individual competition cases. In my view, the successful candidate must have proven knowledge and competence in the analysis of the economic aspects of competition issues, as demonstrated by a solid academic record, evidenced in particular by publications in renowned academic journals, the fulfilment of advisory functions to public bodies, studies and possibly consultancy work in the various areas of competition policy. Further, I think it is important that he/she has a proven ability to manage a team of economists.

- The post will be filled at Director level (for insiders, this is level A2). It is a temporary assignment for 3 years, and is not renewable. During the assignment, the Chief Economist may publish papers and carry out limited teaching assignments provided that these do not interfere with his/her mandate.

- Working for a department famous for its competition spirit, I would of course have liked to open up the vacancy to U.S. economists too. This turned out not to be possible, however. Candidates must be nationals of a Member State of the European Union or of a country which will become a Member State in 2004. Fortunately, there are many European economists that meet the professional standard.

- The application process is starting any day now, so watch out for the next edition of the Official Journal ...

The substantive test for assessment of the competitive impact of mergers

- Let us now turn to the really substantive points. As you remember, the Commission’s Green Paper launched a reflection on the merits of the substantive test enshrined in Article 2 of the Merger Regulation. In particular, it invited comments on how the effectiveness of this test compares with the "substantial lessening of competition" (SLC) test used in several other jurisdictions (and notably in the USA, the UK and Ireland).

- The main thrust of the arguments for a change to SLC is that such a test would be inherently better-suited to dealing with the full range and complexity of competition problems that mergers can give rise to. First, commentators indicated that there might be a "gap" in the scope of our current test. This would refer to cases where the merging firms would be in a position to raise prices, and thus exercise market power, without resorting to co-ordination and without necessarily holding the largest market share in the market. Secondly, by focusing on the question whether or not the merged entity will have a dominant position post-merger, the dominance test would be somewhat static and refer to a notion - "the dominant firm" - that is not necessarily very well understood by economists. SLC would be a concept better in line with modern economic analysis, as it would better focus on the question what is lost in terms of competition through a merger.

- Based on our experience to date, however, the potential drawbacks to retention of the dominance test appear, at least at present, to be more theoretical than real. Indeed, the Commission believes that the dominance test, if properly interpreted, is capable of dealing with the full range of anti-competitive scenarios which mergers may engender. What matters is not the wording of the test itself but the way in which it is applied. The dominance test and SLC have the same ultimate goal: to protect consumers from the potentially negative impact of mergers on the competitive process. As such, it should not come as a surprise that both tests have produced broadly convergent outcomes.

- Moreover, the dominance test has proved to be an instrument capable of being adapted to a wide variety of situations. The test has been successfully used to assess the dynamic impact of mergers, and has not confined the Commission to making static market analyses.

- However, in view to remove the uncertainty which is surrounding the potential "gap" in the scope of our current test, the Commission is proposing to clarify the current substantive test (by the addition of an additional paragraph in Article 2 and of additional recitals to the Regulation) so as to make it clear in particular that the test applies where a merger results in "unilateral effects" in situations of non-collusive oligopoly (the potential "gap" to which some commentators have pointed). The same is made clear in the Draft Guidelines, to which I will return in a moment.

- In my opinion, the clarification has the additional advantage that the wording used to describe dominance in the context of merger control comes closer to the economic concept of market power. After all, one or more companies shall be deemed to be in a dominant position if they "hold the economic power to influence appreciably and sustainably the parameters of competition" (prices, production, distribution or innovation) or "appreciably to foreclose competition". Essentially, this is a description of substantial market power.

- It would be wrong, however, to infer that all this will result in a tightening of EC merger control. We only clarify what we think is already covered by our test. After all, if confronted with a so-called "gap" case, if we could establish that such a case would likely lead to price increases (for example on the basis of reliable cross-regional price data), should we really not intervene? The economic community seems to agree that such cases should indeed be covered by a merger test. The general public would hold the same opinion, I reckon. And I dare to say that also the Court would interpret the test in the same way. In any event, the standard of proof remains as before, i.e. at a very high level, as has been highlighted by the three Court judgments of last year.

- Furthermore, in my impression, much of the unilateral effects analysis contained in the section on non-collusive oligopoly was already inherent in much of our previous case practice. You would be surprised to see how many cases contain references to a "removal of a competitor", "elimination of a source of competition", "elimination of rivalry" in some combination or the other. All we do now in our Notice is to spell out in more coherent economic terms, in what way horizontal mergers ought to be analyzed.

Efficiencies

- Let me now address a second substantive issue, the role of efficiencies in merger control. The Commission intends to give explicit consideration to efficiency considerations in merger cases, from the understanding that efficiencies generated by a merger may enhance the incentive of the merged entity to act pro-competitively, thereby counteracting the effects on competition which the merger might otherwise have.

- In my opinion, efficiency considerations are a natural part (although not the easiest) of a coherent economic appraisal of mergers. As such, it is appropriate that the Commission should look both at the creation or strengthening of market power as a result of a proposed merger and at the possible efficiencies the merger can bring about. In fact, I would say that the main merit of efficiency arguments is precisely to keep the right focus on a case and not to zoom in entirely on what may possibly go wrong in a market. I am convinced that consideration of efficiencies may help competition enforcers to better understand the rationale for a merger and more accurately to assess its impact on market power.

- The precise way in which the Commission will consider efficiencies is also the subject of one of the sections in our Draft Merger Guidelines, to which I will turn now.

The Draft Notice on horizontal mergers

- During the consultations in the Merger Review process, many commentators indicated that the Commission should publish more detailed guidance as to how it assesses concentrations in individual cases. In view of this widely expressed suggestion, the Commission has adopted, for public consultation, a Draft Notice on the appraisal of horizontal mergers. It is intended to complement this Draft Notice with a similar draft on non-horizontal mergers (vertical and conglomerate) and to merge the two documents into a single document, the "EU Merger Guidelines".

- The Draft Notice has been drafted with the view to provide a sound economic framework for the assessment of mergers under the Merger Regulation. In broad lines, the document is structured as follows. After a short introductory section and an overview section, Section III of the Notice describes the appropriate analysis of the various possible types of competitive harm from horizontal mergers. The subsequent chapters deal with particular factors that could mitigate the initial finding. These are, respectively, the existence of countervailing buyer power

(Section IV); the likelihood and sufficiency of market entry (Section V); the existence of efficiencies (Section VI) and the circumstance of a failing firm (Section VII).

- Let me restrict myself to saying a few words on the sections on the possible anti-competitive effects of mergers and on the section on efficiencies.

Scenarios of competitive harm

- As indicated, Section III specifies how horizontal mergers may create or strengthen a dominant position as a result of which effective competition would be significantly impeded. There are three ways in which such an impediment to effective competition may come about.

- The first scenario, the firm with a paramount market position, essentially relates to cases in which the merger may lead to the creation or the strengthening of a firm that has a very large market share and a considerable market share advantage over rival firms. The subsection makes clear, however, that the problem is not "being big", but rather "being not constrained by your rivals". In this context it refers to a number of factors (such as control over input markets or patents) that may allow a firm with a paramount market position to prevent or dissuade rivals to expand.

- The second subsection deals with all cases where the market setting is that of a non-collusive oligopoly. Many oligopolistic markets exhibit a healthy degree of competition. Nonetheless, under certain circumstances, some mergers may diminish the degree of competition by removing important competitive constraints on one or more sellers, who consequently find it profitable to increase prices or reduce output post merger.

- The most direct effect will be the elimination of the competitive constraints that the merging firms exerted on each other. In addition, non-merging firms can also benefit from the reduction of competitive pressure that results from the merger. The elimination of these competitive constraints could lead to a significant price increase or output reduction in the relevant market.

- The section on non-collusive oligopoly distinguishes a number of market situations. For example, it distinguishes between two main types of competition. First, competition in output or capacity refers to situations where firms choose output or capacity and then, given the level of demand, adjust prices to sell this output. This might apply to certain basic commodity industries, where price levels are primarily determined by the overall level of output on the market. Second, competition in prices refers to situations where firms set prices and adjust their production level according to demand.

- This distinction in types of competition is of course a stylized one: there will be cases where the type of competition is not easily characterized as being one or the other. In other industries, the main source of competition is innovation. This, of course, requires a different approach in the merger investigation, as the Notice makes clear. Still, I believe that the two descriptions are useful in highlighting, in the markets concerned, the key issues to be investigated.

- When competition is in output or capacities, the emphasis should lie on the ability and incentive of the rival firms to expand output in response to output reductions of the merging parties. The prime focus of the investigation then naturally lies on the existence of binding capacity constraints on the part of the rivals.

- When competition is in prices, the emphasis should lie on the "closeness" of the products in the market. For example, a merger between two producers that offer products, which consumers view as particularly close substitutes, may generate a significant price increase. If rival firms, however, offer products that are also close substitutes to those of the merging parties, then the post-merger price increase may be limited.

- The third subsection relates to the possibility that the merger may increase the likelihood of co-ordination between the remaining firms following the merger. It specifies that co-ordination is more likely to emerge in markets where it is fairly easy to establish the terms of co-ordination and where such co-ordination is sustainable. Sustainability requires that (i) there is sufficient market transparency, so that the co-ordinating firms are able to monitor to a sufficient degree whether the terms of co-ordination are being adhered, (ii) the existence of a disciplining mechanism to ensure adherence to the co-ordination, and (iii) the absence of possible actions of outsiders, such as current and future competitors, as well as customers, that can jeopardise the results expected from the co-ordination.

Thresholds

- In assessing mergers, I think it is broadly recognized that the overall concentration in a market gives useful preliminary information about the competitive situation in a market. Accordingly, the Draft Notice proposes to use, where appropriate, specific market share or concentration thresholds to specify in which situations the Commission is not likely to have competitive concerns and in which situations it is likely to have such concerns.

- In this respect, we propose to apply the Herfindahl-Hirschman Index ("HHI") as a first indication of the competitive pressure in the market post-merger. For example, the Draft Notice specifies that the Commission is unlikely to investigate cases where the aggregate HHI after the merger remains below [1000]. We have put all the levels in the Notice between brackets, by the way, so as to make really clear that they are up for discussion; we intend to use this period of public consultation to receive feedback on the indicated levels and to continue our research on past cases.

- All in all, we believe that the use of thresholds is a step in the direction of more transparency and predictability of the system. The main problem will always be, of course, where to put the threshold levels.

- Ideally, the thresholds should provide the business community with clear guidance as to which type of transactions would be likely to raise concerns and which wouldn't. But it is important to keep in mind that market shares provide only part of the full picture and can never replace the in-depth assessment of the transaction. To illustrate how difficult the exercise is, one can imagine a transaction that would be an easy clearance because entry is easy, buyers are strong, and alternatives outside the relevant market are easily available. But one could also imagine another context in which a transaction that would lead to exactly the same outcome in terms of market shares would be prohibited because entry is impossible, demand elasticity is low, buyers are fragmented etc.

- As for the Guidelines, what we are basically facing is a trade-off between two types of possible messaging errors. In my view, one needs foremost to avoid the situation that companies wrongfully get the impression from the Guidelines that their merger is not likely to raise concerns, whereas in fact it does. This implies that one needs to have thresholds that minimize the risk of such judgement errors without being so low that they do not give any guidance at all.

- I still have one more general question on the thresholds. It will have occurred to you that we use different types of thresholds for differing circumstances. In the context of homogeneous products, the HHI index is also used to indicate that a concentration is likely to raise serious doubts. We have made this choice on the basis that this index is a more appropriate indicator of market power in this particular context. The thresholds specified in the Draft Notice for the case of differentiated products are, by contrast, based on market shares. This raises for me the question: are we trying to be too specific in our Guidelines? Would we perhaps be better off by having broad, accross-the-board, thresholds? I have an open mind on this.

Efficiencies

- Efficiencies. Section VI of the Draft Notice clarifies the way in which the Commission will explicitly consider efficiency claims. The Draft specifies that the Commission intends to carefully consider any substantiated efficiency claim in the overall assessment of the merger and that it may decide that, as a consequence of the efficiencies that the merger brings about, a merger does not create or strengthen a dominant position as a result of which effective competition would be significantly impeded.

- It is proposed that the Commission takes a relatively cautious approach on efficiencies. Efficiency claims can be accepted where we can be reasonably certain that the efficiencies generated by the merger are likely to enhance the incentive of the merged entity to act pro-competitively for the benefit of consumers, by counteracting the effects on competition which the merger might otherwise have. As such, efficiencies are more likely to make a difference when they are substantial and the possible anti-competitive effects that might otherwise occur are small.

- The Notice also specifies that for the Commission to clear a merger on the basis of efficiencies, these efficiencies have to be merger-specific, substantial, timely, and verifiable.

- Merger-specificity in this context should be understood as saying that the efficiencies are a direct consequence of the merger. I believe this is a logical requirement. In this respect the Commission will concentrate, however, on realistic and attainable alternatives rather than merely theoretical ones.

- Verifiability refers to the fact that the Commission must also be in a position to assess whether the efficiencies are likely to materialize and substantial enough to counteract a merger's potential harm to consumers. Where reasonably possible, efficiencies should therefore be quantified.

- Still, I would like to point out that quantitative analysis should not become a *sine qua non* for the analysis of efficiencies (or for the analysis of possible anticompetitive effect, for that matter). Often the relevant cost and demand data will not be available with sufficient precision or reliability to allow for precise estimation of the likely price effect of a merger. Nor will it very often be possible to determine, on the basis of demand data alone, precisely what the minimum required efficiencies should be for positive effects to result from a merger. In the majority of efficiency cases we will have, if anything, to resort to more qualitative assessments of the welfare impact.

- This is why, I think, our guiding principle that efficiencies are more likely to make a difference when they are shown to be substantial and the possible anti-competitive effects that might otherwise occur are small, is a reasonable one. I interpret these words as meaning that when precise cost and demand data are not available to allow for a precise quantitative estimation and comparison, for the Commission to allow an efficiency defence argument, it must be possible to foresee a *clearly* identifiable positive impact on consumers, not a marginal one.

- Most of the relevant information, which could allow the Commission to assess whether the merger will bring about the sort of efficiencies allowing to clear a merger, is uniquely in the possession of the merging parties. The Notice therefore specifies that it is incumbent upon the notifying parties in due time to provide all relevant information necessary to demonstrate that the efficiencies are merger specific, substantial, timely, and verifiable. Similarly, it is for the notifying parties to provide the evidence necessary to show why the efficiencies will counteract any adverse effects on competition that might otherwise result from the merger and therefore directly benefit consumers.

Conclusion

I think I have spoken for long enough now ... :) I am very curious about the reactions in this room and in the next panel on our draft Guidelines. We are in a process of public consultation, after all, and I intend to fully benefit from this occasion. Many thanks for your attention.