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Impact of the New Substantive Test

Why change the test?
Has it made a difference?

*The views expressed are those of the author and do not necessarily reflect those of DG COMP

The test – old and new

- Old test disallows mergers that
  1. "*create or strengthen a dominant position*

     as a result of which
  2. *effective competition would be significantly impeded*".
- Since May 2004 a merger is challenged if it is likely to:
  - *"significantly impede effective competition*
  - *in particular by the creation or strengthening of a dominant position"*
- *Guidelines*

Why change the test?

Old Test - interpretations

- two interpretations
  - Single criterion: Dominance ⇔ SIEC
  - Cumulative two-tier test: Dominance + SIEC
  - In economic terms dominance equates significant market power (behave dependently *to an appreciable extent* « *raise prices significantly above competitive levels*)
- single criterion approach could lead towards over-enforcement (excessive false positives) as well as under-enforcement (false negatives)
- cumulative two-tier test - Dominance is necessary but not sufficient
  - cumulative test explicitly and unambiguously endorsed by the Courts (Air France ; EDP)
  - yet dominance “may in *certain cases* constitute proof of a significant impediment to competition” (EDP Judgement) - but in which cases is not defined. Still risk of false positives (over-enforcement).

Cumulative two-tier test: an enforcement gap?

- Case practice suggests only market leaders can be dominant
- Dominance sets <u>a level</u> for significant market power and focuses on <u>the merging parties</u>
- Risk of false negatives
  - Dominance does not take the full equilibrium effects into account
  - Only the increased market power of the merging parties.
  - Rivals may react by also increasing their prices
  - Oligopoly theory, effects on consumers

New Test: expected benefits

- Less false negatives (change in equilibrium analysis)
  - When firms sell close substitutes
  - Elimination of a potential entrant
  - Raising Rivals Costs
- Less false positives (clearer emphasis on effects)
  - When a merger leads to efficiencies
  - Countervailing seller power vis-à-vis dominant buyers
- Compare to SLC
- New test does not imply more challenges (only better decisions: less false positives and negatives)
- And/Or, clarifies the above…….

Has the new test made any difference?

Care is needed when making comparisons

- Commission had already embraced a more effects-based approach even under the old test (HMG builds on past practice) => don't expect a structural change on May 1st, 2004.
- It is a process
- What differences are we talking about?
    - Clarity
        - argumentation/investigation
        - credibility/signalling
    - Decisions: gap cases/remedies/efficiencies

Assessment of recent cases

- Bird's-eye-view of competitive concerns raised in cases notified under the new test
  - 21 cases
  - focus on Phase 1 with remedies (18 cases) and Phase 2 (4 cases)
- Checked theory of harm. In particular, the role of
  1. market shares
  2. dominance
  3. product substitutatibility
  4. effects on competition
  5. effects on consumer welfare

Observation 1
Most interventions continue to be based on a finding of creation or strengthening of dominance

- Market shares remain a major criterion.
  - e.g: Penord Ricard/ Allied Domecq concerns are raised wherever the merger achieves a market share higher than 50-55%
- Substitutability is generally assessed but often simply reinforces the inference of dominance from market shares.
  - e.g. Cytec/UCB; Piaggio/Aprilia; Sonoco/Ahlstrom (Ph2)
- In some cases lack of substitutability removes concerns
  - Bertelsmann/Springer (Ph2) (“despite high market shares no price increases because competitors can increase capacity”)
  - Nokia/EADS (not closest competitors, competition with Motorola would not decrease)
  - Bayer/Roche (Austria: 55-60% but other closer substitutes exist)
- Not often any assessment of changes in effective competition or consumer welfare independent of dominance

Observation 2
Vertical mergers may raise foreclosure concerns. But dominance downstream appears to be necessary.

- In Novartis/Hexal the analysis of vertical restraints is heavily based on the notion of market shares

  "With regard to vertical relations … no competition concerns arise from the transaction, <u>as there are limited market shares downstream</u> or alternative suppliers upstream"

- Exception: the investigation in Honeywell/Novar is based on high market shares in downstream markets but <u>also looks at the possibilities for switching</u> and the <u>incentives for Honeywell</u> to foreclose the market

  "The Commission considers it unlikely that Honeywell would have incentives to behave … in such a way that effective competition would be impeded"

Observation 3
Efficiencies have played a limited role

- Cases were mostly cleared for lack of competition concerns, not offsetting efficiency gains.
- P&G/Gillette
  - enlarging the product portfolio might bring efficiencies to retailers and customer (economies of scope, improved service through category captainship)
- In some cases the impact on efficiencies of remedies was taken into account (e.g. Lufthansa/Swiss) – though not stated explicitly in the decision
- Possible interpretations
  - No cases were substantial merger-specific efficiencies gains were relevant
  - Parties are reluctant to make efficiency claims (chicken-and-egg problem)
  - Inertia
  - „Disprove“ competitive concerns, rather than „prove“ efficiencies

Conclusion

- It is a process => evidence on impact difficult to prove (need more time, too early)
- New test has reinforced a trend towards economic effect-based analysis
- How has it made a difference?
  - Clarity – credibility/signalling effects
  - any Gap cases?
  - assessment of efficiencies
- Reaping the full benefits of the new test
  - Fact-finding remains oriented towards an analysis of market structure. New and upgraded survey methodologies may aid in assessing likely equilibrium effects
  - A pro-active assessment of efficiencies (chicken-and-egg problem)