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- Series A—'Economic trends' appears monthly except in August and describes with the aid of tables and graphs the most recent trends of industrial production, consumer prices, unemployment, the balance of trade, exchange rates, and other indicators. This supplement also presents the Commission staff's macroeconomic forecasts and Commission communications to the Council on economic policy.

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Abbreviations and symbols used

Member States

B	Belgium
DK	Denmark
D	Germany
WD	West Germany
GR	Greece
E	Spain
F	France
IRL	Ireland
I	Italy
L	Luxembourg
NL	The Netherlands
P	Portugal
UK	United Kingdom
EUR 9	European Community excluding Greece, Spain and Portugal
EUR 10	European Community excluding Spain and Portugal
EUR 12−	European Community, 12 Member States including West Germany
EUR 12+	European Community, 12 Member States including Germany

Currencies

ECU	European currency unit
BFR	Belgian franc
DKR	Danish krone
DM	German mark (Deutschmark)
DR	Greek drachma
ESC	Portuguese escudo
FF	French franc
HFL	Dutch guilder
IRL	Irish pound (punt)
LFR	Luxembourg franc
LIT	Italian lira
PTA	Spanish peseta
UKL	Pound sterling
USD	US dollar
SFR	Swiss franc
YEN	Japanese yen
CAD	Canadian dollar
ÖS	Austrian schilling
R	Russian rouble

Other abbreviations

ACP	African, Caribbean and Pacific countries having signed the Lomé Convention
ECSC	European Coal and Steel Community
EDF	European Development Fund
EIB	European Investment Bank
EMCF	European Monetary Cooperation Fund
EMS	European Monetary System
ERDF	European Regional Development Fund
Euratom	European Atomic Energy Community
Eurostat	Statistical Office of the European Communities (SOEC)
GDP (GNP)	Gross domestic (national) product
GFCF	Gross fixed capital formation
LDCs	Less-developed countries
Mio	Million
Mrd	1 000 million
NCI	New Community Instrument
OCTs	Overseas countries and territories
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of Petroleum Exporting Countries
PPS	Purchasing power standard
SMEs	Small and medium-sized enterprises
toe	Tonne of oil equivalent
:	Not available

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Foreword

At the end of the 1980s, the prospect of the completion of the internal market motivated a growing number of companies in the Community to expand into other Member States by means of mergers and acquisitions. Cross-border mergers involving Community companies reached historic records. This European merger wave revived discussions on merger control at Community level which had been going on since 1972 without achieving the required consensus. DG II contributed to the renewed debate in *European Economy* No 40 of May 1989 which provided an overview of the economic issues involved.

The discussion showed that Community merger control would both facilitate Community integration and contribute to the protection of effective competition in the internal market. As emphasized in many studies — for example, 'The economics of 1992' (*European Economy* No 35, March 1988) and 'The impact of the internal market by industrial sector' (*European Economy*, Special edition 1990) — external growth by means of mergers and acquisitions can be a means of quickly realizing potential cost savings and integration gains offered by the internal market. But effective competition has to be safeguarded to make sure that efficiency gains are passed on to consumers.

Without Community merger control, mergers with an impact on markets in several Member States risked being challenged by different national merger control authorities on the basis of substantially different national competition laws. The complexity of merger controls at national level threatened to become a barrier to Community integration. A 'one-stop shop' for merger control became desirable for enterprises which wanted to merge across national boundaries.

From the point of view of national competition policy, the growing internationalization of previously national markets posed considerable problems, from the difficulty of investigations in other countries to extra-territorial enforcement. Furthermore, the possibility could not be excluded that divergent national merger control policies would distort the restructuring processes of the internal market.

While the Community could apply Articles 85 (cartels) and 86 (abuse of a dominant position) under specific circumstances to mergers, their coverage was clearly not adequate. On 21 December 1989 the Council therefore adopted a new legal instrument at Community level for the control of major concentrations, the Merger Regulation. It came into effect on 21 September 1990. The thresholds defining Community jurisdiction were initially set rather high with a view to a later revision. Until then only the biggest mergers in the Community are subject to review at Community level whereas the larger part — even if they are cross-border — is still controlled by national authorities.

Some three years into the application of the Merger Regulation this issue of *European Economy* returns to the economic questions of Community merger control. It pursues two objectives: first, to document the working of the new Regulation. Chapter 1 provides a short guide to its substance and procedure. Its full text and some implementing legislation can be found in Part C. An annex to Part A puts the Merger Regulation in the wider context of Community competition policy. Chapter 2 analyses the European merger wave and shows that while it has slowed down, sizeable mergers and acquisitions occurred with considerable impact on economic structures across the Member States. This is underlined by the fact that the number of mergers of Community dimension notified to the Commission has remained quite stable at some 60 per year. The case statistics are provided in Chapter 3 which also shows that while the Commission has only prohibited one single concentration the enterprises subject to Community merger control had to accept conditions to their intended concentration in nearly 10% of the cases submitted.

The second objective of this issue of *European Economy* is to contribute to the economic debate on key questions of Community merger control: market definition, the assessment of the competitive impact and the special problems of oligopoly analysis. The approach developed by the Commission is discussed in Chapter 4. In Part B three academic experts provide their personal views on specific economic issues to stimulate the discussion. Their papers address the definition of the relevant market (L. Sleuwaegen), the analysis of oligopolistic dominance (P. J. Williamson) and the institutional structures of Community merger control (P. Seabright). The opinions expressed commit only the authors and do not reflect the views of DG II or of the European Commission.

In the three years of its existence the Community Merger Regulation has become an operational instrument for the control of mergers which have a Community dimension. The transparency and efficiency of its application are widely recognized. The Commission has declared its intention to review the Regulation by 1996. This issue of *European Economy* should provide a contribution to the economic debate which is necessary in this respect.

Heinrich Matthes
Chairman of the Editorial Board of
European Economy

Part A

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Executive summary

The European Community's approach to merger control is part of a competition policy whose evolution has been quite distinct from equivalent national policies. Devised to serve the Community's objective, laid down in the Treaty of Rome, of ensuring that competition 'in the common market is not distorted', it is also an instrument to facilitate integration and the further development of the internal market. The Merger Regulation, which came into force in September 1990, genuinely extended and clarified the Community's responsibilities concerning merger control. After three years it is timely to review its application. This issue of *European Economy* continues the analysis of the economics of EC competition policy which was launched in *European Economy* No 40 of May 1989 on EC merger control and *European Economy* No 48 of September 1991 on Community control of State aids.

The present issue gives an overview of merger activity in the Community in recent years and discusses the experience gained in the first three years of application of the Merger Regulation. Three expert papers in Part B provide detailed analyses of some specific problems of merger control.

Merger activity in the Community

Merger activity in the European Community since 1986 has been both stimulated by the single market programme and facilitated by strong economic growth. The number of mergers and acquisitions increased until 1990, although a peak in the value of transactions was registered in 1989 when three of the 10 largest deals in the 1986-92 period were concluded.

One explanation for this activity is that the single market has encouraged firms to concentrate on their core businesses by divesting non-core activities and establishing a Community-wide basis for their operations. The desire to restructure was particularly powerful at the beginning of the period, when nearly half of the mergers of 1985-86 were explained by the companies involved in terms of rationalization and synergy. By 1991-92, the same motives accounted for only 16% of mergers, while strengthening of market position and expansion emerged as the dominant reasons.

Majority acquisitions were much the most common type of merger concentration, and accounted for similar proportions of all mergers at both national and Community levels — the former involving companies from the same Member State and the latter cross-border transactions within the Community. Minority stakes and joint ventures were also similarly important at national and Community levels, but joint ventures were a significantly weightier share of international concentrations which, by definition, include at least one non-EC company.

Purely national mergers peaked in 1989, while the number of cross-border deals continued to rise at Community and international levels in 1990, and remained at historically high levels in 1991 and 1992. This pattern may be partly explained by single market pressures encouraging companies to reorganize within national markets before turning towards the Community. Economic conditions seem to be important in explaining the volatility of Community and international deals; they are larger and riskier for the companies involved, and much more vulnerable to sentiment about the economic outlook. Mergers involving companies from outside the Community followed the same trend as Community acquisitions, reinforcing the conclusion that the growth of mergers and acquisitions was stimulated by the single market.

The United Kingdom, which has traditionally led the Community in M&A activity, was overtaken by France as the most active cross-border bidder during 1990-92. Both countries have corporate sectors with a long experience of mergers as well as developed take-over markets. The much smaller German cross-border merger activity during the period was due to the traditional preference for internal growth, the priority companies gave to exploiting growth opportunities offered by unification, and also by an inward-looking small and medium-sized business sector.

The influence of French and British companies on Community markets has been strengthened by their acquisitions. UK firms' purchases were concentrated on Germany and France, while French companies spread their net more widely in Germany, Spain, the UK and Italy. For quite different reasons, German and Spanish firms were both targeted much more often than they bid across borders: German companies, in part because of the domestic pre-occupations mentioned above, and Spanish companies for various reasons, e.g. more focus on internal growth, lack of financial resources, etc.

Privatization in East Germany helped slow the 1990-92 decline in M&A transactions to the extent that take-overs in Germany represented more than a quarter of total internal Community deals during that period. Nevertheless, foreign investors accounted for only 8% of the acquisitions in East Germany up to mid-1993, although they appear to have bought some of the larger businesses on sale.

The USA was the most active third country bidder in the Community in the 1990-92 period, accounting for 35% of total activity. Switzerland and Sweden led the EFTA countries. The USA was also the most important non-EC target for Community companies, accounting for 38% of all cases. Switzerland was the second most preferred target and Hungary, Czechoslovakia and Poland all feature, with Japan, in the 12 most targeted.

Banking and insurance have shown the largest increases in M&A activity since 1986, largely because the single market is removing important barriers to trade in the financial services sector.

Mergers between companies in different sectors — so-called non-horizontal mergers — accounted for more than a third of total activity. A large proportion involved acquisitions in banking and insurance by holding companies and other non-banking financial operators.

The Merger Regulation

Between the entry into force of the Merger Regulation on 21 September 1990 and the end of June 1993, 164 merger operations were notified to the Commission. Of these, 17 were found not to fall within the scope of the Regulation, 129 were judged not to be a serious impairment to competition, 11 were examined in detail because they posed prima facie danger to competition and one merger was prohibited — the take-over of de Havilland by Aérospatiale and Alenia. In most of the 11 cases subject to so-called Phase 2 scrutiny, the Commission made its approval conditional on the parties fulfilling commitments aimed at preventing the creation of dominant positions. Commitments to resolve competition problems were also required of seven of the 129 cleared in Phase 1.

Majority acquisitions and true mergers made up 50% of the notifications to the Commission and only two acquisitions of minority shareholdings were reported, although such operations are 25% of operations recorded in the Commission's DOME database.

A surprisingly large proportion (47%) of the notifications received by the Commission were joint ventures. This contrasts with database evidence showing joint ventures accounting for a mere 17% of deals involving large firms from June 1990 to May 1992.

A very high proportion, 71%, of deals examined by the Commission were cross-border transactions and only 18% involved firms based in the same Member State. The majority of cases (108) were in industrial sectors and 77 were in the services sector. These figures include 21 cases which are counted twice because they involved both industry and services. Chemicals, electrical and electronic products and motor vehicles were the prominent industrial sectors, and distribution, business services and insurance the main service activities. In general however, the Regulation covered only a very small proportion of the deals in banking and business services.

The number of notifications received by the Commission contrasts with database evidence for 1990-92 of more than 1 400 concentrations worth more than ECU 25 million. It is clear that the Merger Regulation's three very high thresholds for establishing a Community dimension to a merger are excluding a large number of transactions of potential interest to the Community. The limiting effect, for example, of the requirement that the enterprises involved should have a world-wide combined turnover of more than ECU 5 000 million is demonstrated by the fact that in 1992 there were only 102 industrial enterprises in the Community with a turnover above this threshold. The problem is that industrial sectors have quite different levels of turnover, and some are so small that a Community-wide monopoly would still not attract attention under the Merger Regulation.

In general, therefore, the uniform thresholds require Community scrutiny for too many concentrations involving large conglomerates, and too few with smaller specialized enterprises. Since 1991, only eight out of 47 concentrations with a value of more than ECU 500 million, involving at least one Community firm, have been notified to the Commission. Moreover, the Community cannot request a Member State to refer a case below the thresholds, although Member States can request referral from the Community. Lower thresholds and a referral system which brought more flexibility to defining the boundaries between Community and national responsibilities would be obvious improvements.

These boundaries must obviously respect the principle of subsidiarity which now guides the shaping of many EC policies. But the difficulty in applying subsidiarity to merger control lies in the possible spillover effects into other Community markets of a purely national concentration. Moreover, the potential for spillovers is growing with the progressive integration of the internal market and the resulting growth in intra-Community trade. There is reason to believe that the much lower thresholds sought by the Commission in the negotiations on the Merger Regulation (60% lower than those established) would have brought a substantial number of mergers with spillover effects under Community control. In July 1993, in a first review of the application of the Regulation, the Commission found that there were strong arguments in favour of lowering the thresholds. However, as most Member States were opposed to any change, the present levels will remain at least until the next full review in 1996.

There is a wide variation in thresholds fixed by national governments. General turnover thresholds are lowest in the USA and the UK as a proportion of gross domestic product. Greece and France, by contrast, require a combined turnover of 0,1% of GDP before a concentration may be subject to control. Differences between Member States imply that a concentration could be subject to control in one country, but not in another where it might have higher sales. There is clearly room for convergence between national requirements.

During the Regulation's three years in operation, a distinct procedure has emerged for assessing notified mergers once Community jurisdiction has been established. It is based on three steps:

Step one determines the relevant product market.

Step two determines the relevant geographic market.

Step three assesses whether a merger creates or strengthens a dominant position. Four elements are examined: the market position of the merged firm (market share and other competitive advantages); the strength of remaining competitors; customers' buying power and potential competition.

Market shares regularly provide the starting point of an assessment of dominance. If a post-merger market share is less than 25% of the relevant market, then the Regulation presumes that the concentration is of no concern. No straightforward link has emerged between market share above 25% and the outcome of the assessment. It can only be observed that, on one hand, the Commission has so far not reacted negatively to a merger with a post-merger market share below 40% and, on the other hand, that every merger with a market share above 60% has at least triggered a Phase 2 procedure. Differing views of market share have been taken according to the market in question: shares tend to be less entrenched in dynamic markets with high rates of technological development and rapidly changing structures. Stable, entrenched market shares may point to market power, as do large gaps in market share between merged companies and the strongest competitor.

In arriving at a decision, the Commission takes into account the widest possible combination of factors shaping competitive conditions in a particular market. The more factors which point to a dominant position, the more likely a procedure will be opened, followed by pressure for remedies and, ultimately, a prohibition. The latter is likely to be considered only in those rare cases where the large majority, if not all, of the relevant factors point to the creation, or substantial strengthening of a dominant position. The Aérospatiale-Alenia/de Havilland prohibition was justified by very high market shares in a global market, high barriers to entry and the maturity of the market.

Whether the Merger Regulation applies to situations of oligopolistic dominance is still being debated by lawyers although the Commission has no doubt that it does. The Regulation itself does not specify whether it covers situations in which more than one firm together could exercise market power. The Commission has assessed the potential creation of oligopolistic dominance in four cases (Fiat Geotech/Ford New Holland, Varta/Bosch, Alcatel/AEG Kabel, Thorn EMI/Virgin) but it left the jurisdictional question open by arriving at a negative conclusion on the substance. In Nestlé/Perrier, however, it found oligopolistic dominance and applied the Regulation. The concentration was allowed only after Nestlé committed itself to selling sufficient mineral water production capacity to permit the creation of a third force in the market.

Assessment of oligopolistic dominance is particularly important for the future. The completion of the internal market could leave important markets dominated by a few firms — especially in sectors like airlines and telecommunications where national markets have been dominated by single companies. Community control will be needed to ensure an effective system of undistorted competition.

Chapter 1

A short guide to substance and procedure of the Merger Regulation

The Regulation on the control of concentrations between undertakings[1] or Merger Regulation was adopted in December 1989 to come into effect on 21 September 1990. It created a new Community instrument to control concentrations beyond the application of Articles 85 and 86 EEC which had remained limited to special cases.[2] The Merger Regulation gives the EC Commission the exclusive responsibility to control mergers of a Community dimension; smaller mergers remain in principle under the control of national authorities. The division is made on the basis of the turnover of the enterprises involved. A concentration is considered as having a Community dimension where:

(i) the aggregate world-wide turnover of all the undertakings concerned is more than ECU 5 000 million (general threshold),

(ii) the Community-wide turnover of each of at least two of the undertakings concerned is more than ECU 250 million (*de minimis* threshold), unless

(iii) the undertakings concerned do not all achieve more than two thirds of their Community-wide turnover within one and the same Member State (two-thirds rule).

The Merger Regulation applies to concentrations, i.e. arrangements whereby one or more persons or an undertaking acquire control of an undertaking and thus change the structure of companies and of the market they operate in. This is in contrast to cartels (in the sense of Article 85) where the undertakings involved remain independent. The assessment of whether an arrangement actually constitutes a concentration is particularly difficult in the case of joint ventures. A joint venture, that is an undertaking which is subject to the joint control of two or more other undertakings (parents), can be considered concentrative, if the joint venture performs on a lasting basis all the functions of an autonomous economic entity, and if its creation does not give rise to the coordination of competitive behaviour of the parents among themselves or between them and the joint venture.[3] Otherwise the joint venture is considered cooperative and may be subject to Article 85.

Control is characterized by the possibility of exercising decisive influence on an undertaking. Therefore, for example, the purchase of securities by financial institutions as part of their normal activities without influencing the competitive activities of the enterprises, that is for portfolio investment, is not considered a concentration in the sense of the Merger Regulation.

The Commission has to assess whether the concentration 'raises serious doubts as to its compatibility with the common market' (Article 2 of the Merger Regulation). This depends on whether the concentration would create or strengthen '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'. Factors to be taken into account are: market structures, actual or potential competition from inside or outside the Community, the market position of the undertakings concerned and their economic and financial power, the opportunities available to suppliers and users, barriers to entry, supply and demand trends, the consumer interest and the development of technical and economic progress, provided that it is advantageous to consumers and does not form an obstacle to competition. If the analysis concludes that there is indeed a creation or strengthening of a dominant position as a result of which effective competition would be significantly impeded, the Commission has to prohibit the concentration.

The starting point for the procedure of Community merger control is the mandatory notification: if an arrangement between undertakings could be considered a concentration and could meet the Community-dimension thresholds, it must be notified to the Commission within one week.[4] To carry out its assessment, the Commission has extensive rights to obtain information and to investigate.

No concentration may be put into effect before notification or within the three weeks following notification. If necessary, the Commission can decide during this initial period to extend the suspension of a concentration until it has taken a final decision on the case.

[1] Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings, OJ L 257, 21.9.1990, pp. 13-25.

[2] See Annex to Part A of this issue.

[3] Article 3(2), paragraph 2 of the Merger Regulation and Commission notice regarding the concentrative and cooperative operations under Council Regulation (EEC) No 4064/89 of 21 December 1989, OJ C 203, 14.8.1990, pp. 10-15.

[4] Procedural details and the form CO to be used for notification are specified in Commission Regulation (EEC) No 2367/90 of 25 July 1990 on notifications, time-limits and hearings provided for in Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings, OJ L 219, 14.8.1990, pp. 5-25.

Within one month after proper notification, the Commission has to take a first decision: if it concludes that the concentration either does not fall within the scope of the Merger Regulation (Article 6(1)(a)) or does not raise serious doubts about its compatibility with the common market (Article 6(1)(b)), the Commission issues a decision to that effect. If a decision of compatibility is taken under Article 6(1)(b), the concentration can proceed without risk of further interference by national or Community authorities: for concentrations of a Community dimension merger control has become a one-stop shop.

If there are, however, serious doubts about a concentration's compatibility with the common market, the Commission has to decide to initiate proceedings (Article 6(1)(c)). Within a further four months the Commission proceeds with its investigations into the circumstances of the merger, hearing the parties concerned and the Advisory Committee on Concentrations where the Member States are represented, and possibly taking into account modifications submitted by the undertakings concerned, before taking a final decision, approving the merger (Article 8(2)) or prohibiting it (Article 8(3)). An approval may be conditional on specific commitments by the parties. If the final decision is negative, the Commission may require the separation of assets or undertakings where a concentration has already been implemented (Article 8(5)). The Commission's decision is final throughout the Community subject to review by the Court of Justice. If an undertaking does not comply with a Commission decision, concerning, for example, the suspension or the prohibition of a merger, the Commission may impose fines of up to 10% of the aggregate turnover of the undertakings concerned.

There are two exceptions to the normal distribution of responsibilities between the Commission and the national authorities:

(i) even if a merger has a Community dimension, a Member State may ask for a case to be referred to its competent authorities if it considers that a concentration threatens to create or strengthen a dominant position in a distinct market within its territory. It is then up to the Commission to decide whether to refer the case or to deal with it itself (Article 9);

(ii) even if a merger has no Community dimension, a Member State which does not have the means or desire to deal with it itself may request the Commission to take decisions to safeguard competition within the territory of the Member State concerned (Article 22(3) and 22(4)).

Furthermore, a Member State may invoke legitimate interests other than those taken into consideration by the Merger Regulation and take appropriate measures. Examples of such legitimate interests are public security, plurality of the media and prudential rules. In such cases the Commission must decide whether the interest claimed is compatible with Community law (Article 21(3)).

Chapter 2

Evolution of mergers in the Community

Considerable variations in the number and volume of mergers and acquisitions have been apparent over the last 10 years. After a steady increase until 1989-90, activity began to decline and has not yet stabilized.

This evolution leads to several questions. Are the changes structural ? Are there differences between countries? Between sectors? What are the effects of the single market? Does economic growth have an influence? For an analysis capable of answering such questions, it is necessary to resort to the use of specialized databases.

This section presents a picture of the overall trends since 1986, and a more detailed analysis from 1990. The sources of information are described in a separate box.

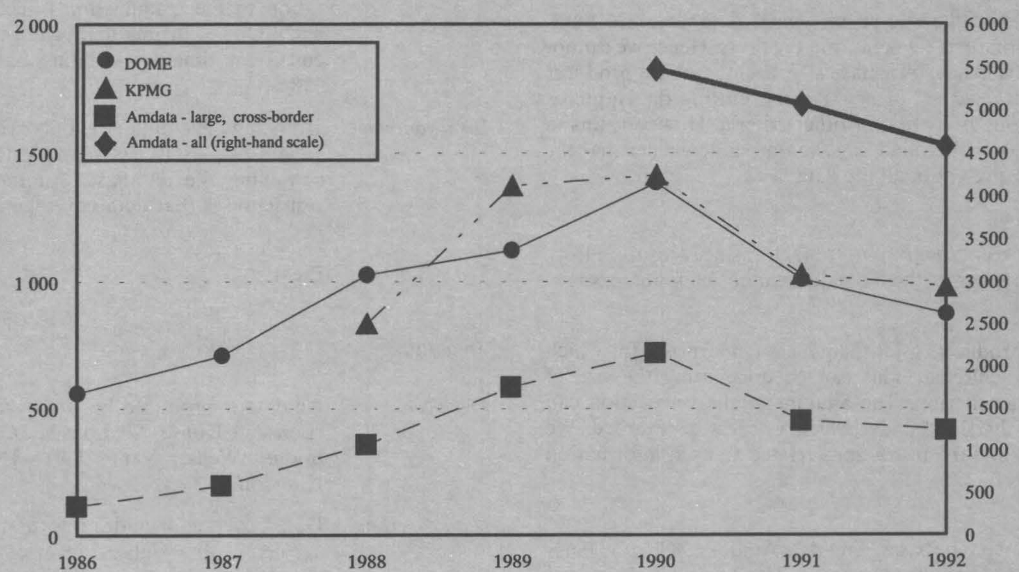
2.1. Overall trend of merger activity in the Community

2.1.1. Overview

Graph 1 shows the overall trend of the number of mergers and acquisitions of Community enterprises. The three sources of information used all present a rather similar picture. After a steady increase from 1986, a peak occurred in 1990. Then a decrease is observed until 1992, and there are signs that this decline is continuing. Two curves are given using Amdata. The first one includes only major cross-border bids since 1986 and the second one includes all bids since 1990. This distinction is made because only data on major bids are comprehensive for the whole of the period under consideration, while information on small bids has only been included gradually for European countries. A third curve is based on DOME and includes exclusively large enterprises. The fourth one displays data provided by KPMG and considers only cross-border deals. The differences in coverage between the databases explain the large gaps that exist in absolute numbers. Furthermore, the curves normally describe the number of deals where a Community

GRAPH 1: Evolution of mergers and acquisitions where a European enterprise is targeted[1]

Comparison between databases



[1] For DOME: with an effect in the Community, the time period is from July to June: 1986 = July 1985 to June 1986.
Sources: DOME, KPMG, Amdata.

enterprise is targeted, except for DOME where deals with an impact on the Community's economy are considered. This coverage convention will be applied throughout this chapter unless otherwise stated.

Because of these differences, particular care is required when using databases on mergers and acquisitions. In addition to the deliberate data coverage restrictions mentioned above, producers of databases face a number of difficulties when compiling the information. Solutions vary, and as a consequence there are many disparities between bases. A shaded box describes the databases used for this study and emphasis is put on the differences that may exist between them.

Box 1: Sources of information and statistical inconsistencies

A first element that gives rise to possible inconsistencies is the date when the transaction is considered to have taken place. This can be the starting date, the completion date, or even the date of notification. Hence the same deal may be attributed to different years depending on the database used. The bias is obvious for time-series analysis. It can be important for yearly volume graphs especially when large transactions are concerned.

The classification of firms by sectors also causes problems. Because most enterprises are active in several sectors, classification by this criterion is left to the producer's discretion. These differences make sectoral analysis difficult.

Most important is the source on which databases are built. Normally, information is taken from the press. Hence we cannot be sure that it is exhaustive. Basically, each database producer monitors a particular set of newspapers, putting the emphasis on certain regions, activities, or other criteria. However, this in general occurs only for small bids, so one can consider that the major deals are present in all the databases.

Confidentiality is another important factor, since sensitive information, like turnover or the bid value, cannot be found easily.

Furthermore, producers limit the panel of enterprises for which information is collected. This can be done using the size of enterprises as a criterion. The amount of the transaction can also serve as a threshold under which a deal is disregarded. We will describe below the restrictions related to each information source.

Here we use three databases: DOME, Amdata, KPMG. Each has its advantages and disadvantages. The point is to be aware of the differences, and to use the databases in a complementary fashion so as to exploit the individual strengths.

DOME

Producer — The DOME database was started in 1971 by the Commission — DG IV — Directorate-General for Competition. It has been extensively used for producing the annual reports on competition policy.

Data coverage — DOME considers operations involving the 1 000 largest European industrial enterprises, the 500 largest world-wide firms, and the most important in the service sector. Both cross-border and intra-border deals are covered.

Assets — Designed for the Commission's use and developed in-house, DOME has transparency and a high level of reliability. Its clear adaptation to the Commission's needs is also an asset. One of the main advantages is the long, consistent time-series dating back to before 1986.

Disadvantage — Unfortunately data are only available until June 1992, as it has been decided to cease compiling the database. Another important restriction is that data coverage is rather limited.

Sources — Press.

Amdata

Producer — Amdata is produced by *Acquisitions Monthly* (Lonsdale House, 7/9, Lonsdale Gardens, Tunbridge Wells, Kent TN1 1NU, United Kingdom).

Data coverage — Data coverage includes information on management buy-outs, reverse take-overs, divestments, strategic alliances, stakes, trail data, as well as private and public deals. Amdata market coverage dates back to

January 1984 for major domestic and cross-border transactions world-wide. The database covers over 40 000 deals. The United Kingdom is particularly well represented as it was the first country monitored for small bids. Other European countries were included gradually. Information about enterprises should be present, but much is often missing. The explanation for this can be found in confidentiality constraints on sensitive data. Anyway, this kind of information is provided in addition to that more usually provided by mergers and acquisitions databases.

Assets The database contains several original features. Major domestic and cross-border transactions can be used for analysing long-term trends.

Disadvantage Because small and medium transactions are in general not included before 1990, Amdata is only positively reliable and exhaustive after this date. Another important figure is also often missing: the bid value. But in-depth screening of the database has shown that this is normally the case only for small bids and that the aggregated values in the database can be considered as excellent indicators of the real amounts engaged by enterprises.

Sources The primary sources are original documents such as press releases, company reports, local government registration lists, offer documents and listing particulars. Experts are located in several countries and constitute a network. Amdata also monitors the international financial press.

KPMG

Producer KPMG — International Office: WTC, Strawinskylaan 957, 1077 XX Amsterdam, The Netherlands.

Data coverage KPMG's statistics analyse three different types of cross-border deal: outright acquisitions from 1987, minority participation and joint ventures from 1990. More than 17 500 deals involving 120 countries are carried on the database.

Assets One of the main assets is reliability. Indeed, this database has been regularly quoted. It has also been widely used in several studies.

Statistics are published quarterly in *Deal Watch,* and KPMG also produces tailored reports.

Disadvantage On the other hand, KPMG has limited the database coverage to cross-border deals, and hence is comprehensive only for these sorts of mergers. This can be a handicap since domestic deals are of the utmost importance for specific analysis. This is the case, for example, in describing the effect of German unification.

Another important element from an operational point of view is that the database cannot be directly accessed. This can imply a lack of transparency concerning the production process of elaborated outputs. Furthermore, data on individual deals are not available.

Sources Maintenance of the database is done by monitoring business newspapers, as well as receiving information from press agencies.

Advantages and disadvantages of each database

DOME

pro: Long time-series
Reliability

contra: Small sample size
Abandoned in 1992

Amdata

pro: Large sample size
Includes enterprise data
Very reliable for the UK
Fully reliable from 1990

contra: Much complementary information missing (turnover)
Bid value of small deals missing
Inconsistencies for small bids before 1990

KPMG

pro: Reasonably large sample size
Regularly quoted

contra: No enterprise values available
Individual data unavailable
Cross-border only

2.1.2. Evolution of EC M&A activity

2.1.2.1. Cyclical behaviour of M&A activity

The cyclical behaviour of M&A activity observed in the period 1986-92 is typical for merger activity in general. The US experience,[1] in particular, shows that mergers happen in waves. Looking at US data, three major merger waves can be distinguished which, however, seem to be quite distinct in nature.

The first US wave took place roughly from 1887 to 1904 and was characterized by a push for monopolization. The second merger wave occurred between 1916 and 1929. The firms involved in this wave showed a strong tendency towards the creation of oligopolies. The third wave peaked in 1968, where mergers were embarked on with the aim of diversification and creating large conglomerates.

Although data on European merger activity do not date back as far as those of the USA, it is quite clear that Europe has followed a different path with regard to merger activity. The situation after the second World War was strikingly different from that of the USA. One major reason for this was the lack or rather late adoption of national merger regulations in Europe. While the USA had possessed comprehensive merger regulations since 1904 (coinciding with the end of the first merger wave), the United Kingdom only adopted such legislation in 1965. The Federal Republic of Germany followed suit in 1973. The first recorded European merger wave took place between 1958 and 1970, when trade barriers were lowered significantly following the establishment of the EEC.

Between 1986-92 a second European merger wave seems to have taken place. While the first one was induced by a lowering of trade barriers resulting in fiercer competition amongst European nations, the latest wave coincided with the single market programme.

2.1.2.2. Number of transactions versus total value of transactions

Mergers and acquisitions activity can be measured using different criteria. The number of transactions reflects the level of activity, but the aggregated value indicates the real effort that enterprises are able or willing to make for their external growth. Only a small share of transactions are important when considering overall amounts involved.

Therefore, different indicators for assessing activity give varying results. In this section, we introduce the two most common indicators on which further analysis will be based: the number of deals and the total value of deals.

Graph 2 shows the number of cross-border deals where a European enterprise was targeted. Different curves were constructed according to different deal values. The upper curve represents all the deals listed in Amdata, with or without bid values. The second curve includes only the deals for which a value has been introduced into the base. The large gap between the two curves is said to be constituted mainly by small-sized bids. The bottom curves show the evolution of the number of larger bids: bids with a minimum value of ECU 25 million and ECU 100 million respectively. A first observation is that the trend is similar for all curves, but it is more pronounced of course when smaller bids are included. Therefore, it can be said that the activity trend expressed in number of deals is not dependent on their related values.

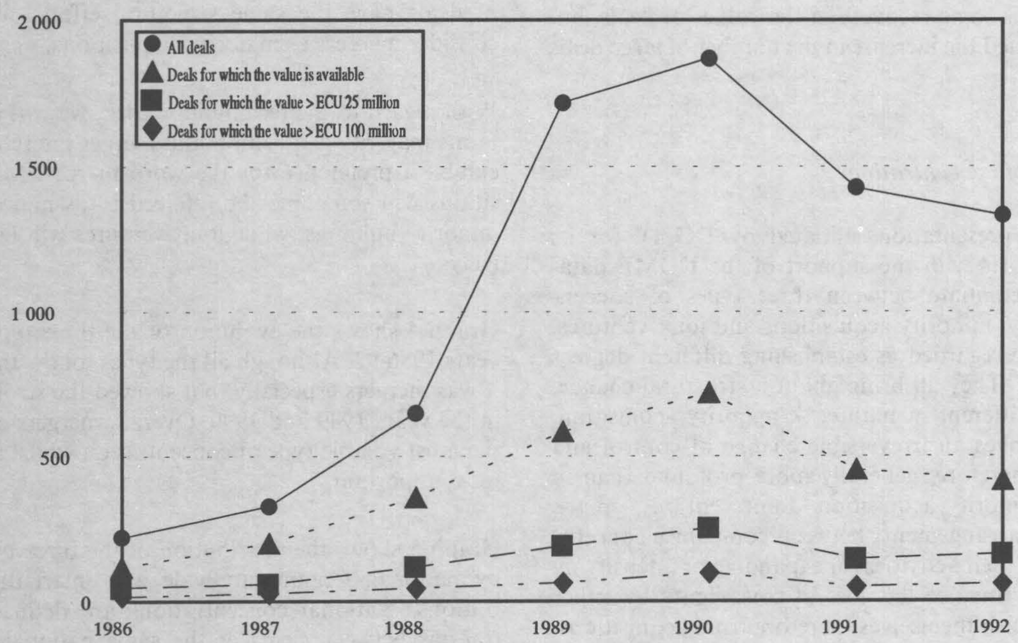
Graph 3 shows the evolution of total values. The upper curve takes into account all valued deals. The other curves include the deals with values over ECU 25, 50 and 100 million. The very small gaps between the curves indicate clearly that the larger bids drive the trend, leaving very little importance to small bids regardless of their number. Hence, the missing values for a number of deals are more than likely related to the smaller ones, and the aggregated values remain a good indicator of the total amount engaged.

As mentioned before, the number of mergers and acquisitions increased until 1990 (more sharply up to 1989) and decreased thereafter. But the peak occurred a year earlier, in 1989, if the cumulated value of transactions is used as the criterion. This is explained by the important number of very large deals completed in 1989. Indeed, over the reference period, three of the 10 largest deals took place in that year. For instance the acquisition of Beecham (UK) by Smith Kline (USA) for ECU 6 894 million in the pharmaceutical products sector. Another occurred in the food sector: BSN SA (France) took over RJR Nabisco Inc. (USA) in a deal worth ECU 2 345 million. Finally, Jaguar (UK) was acquired by the Ford Motor Company (USA) for ECU 2 204 million. The largest deal in 1990, worth ECU 1 962 million, ranked only 12th among all the deals that took place during the seven years under consideration. This was the acquisition of the German holding company Feldmuehle, active in the paper and pulp sector, by the Swedish company Stora Kopparbergs Bergslags AB.

Another factor that can be related to the total amount of transactions is the financial profitability of enterprises. The

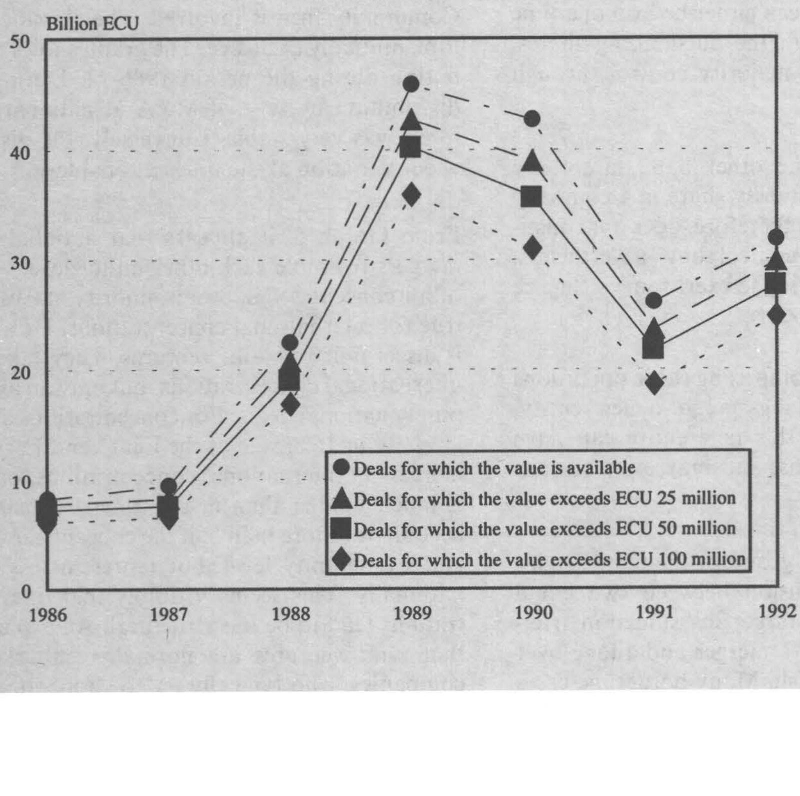
[1] See Scherer and Ross, *Industrial market structure and economic performance*, 1990.

GRAPH 2: Number of cross-border deals where a European enterprise is targeted



Source : Amdata.

GRAPH 3: Value of cross-border deals where a European enterprise is targeted



Source : Amdata.

graph of the return on equity ratio shows the same trend and peaks in 1989.

In 1992 there was some recovery in the values of deals, but this clearly reflected the increase in the number of large deals that year.

2.1.2.3. Types of concentrations

A conventional presentation, initiated by DG IV for its competition reports with the support of the DOME database, is to differentiate between three types of concentrations: majority, minority acquisitions and joint ventures. The three can be regarded as establishing different degrees of concentration. They all bring about a structural change, but are rather different in nature. A majority acquisition, for instance, implies an irreversible change of control and its effects are, therefore, generally more profound than in the case of a minority acquisition. Joint ventures, on the other hand, are arrangements between companies concerning only a part of their activities for expanding or intensifying operations. They involve less loss of sovereignty by either firm and distinguish themselves therefore from acquisitions.

The following pragmatic definitions will be used for classifying concentrations:

(i) a majority acquisition is a concentration where an undertaking obtains through acquisition a majority in another's voting shares; this can either be by a one-time acquisition of more than half the outstanding shares, or a gradual attainment of majority control through several minor acquisitions;

(ii) minority acquisitions, on the other hand, are those acquisitions where only a minority share in a company is obtained; a minority share, therefore, does not constitute an attainment of full control but, nevertheless, allows an acquiring undertaking to exert some influence over the decision-making process;

(iii) a joint venture is defined as comprising those operations where at least two undertakings create a new entity, which is jointly controlled; this new entity can have industrial or commercial aims, and may even be constructed for a limited period.

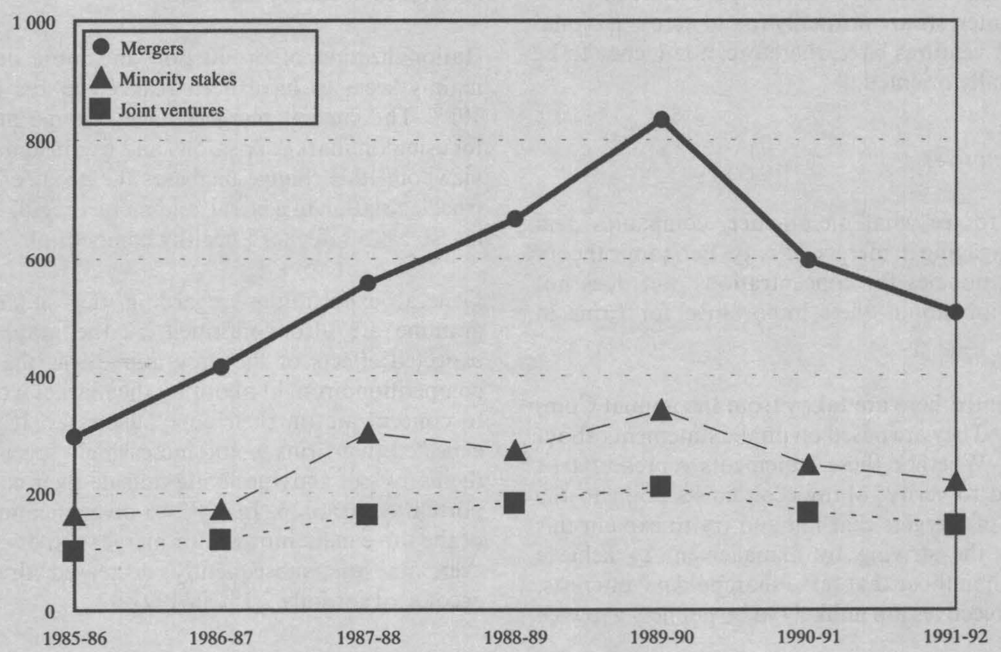
Mergers are not considered as a group in their own right. Although a merger implies a fusion between two equal partners and renders the buyer-target classification irrelevant, a clear distinction between a merger and a take-over is in practice impossible to establish. Many borderline cases exist for which, even *ex post*, it is not clear if a deal was a simple take-over or a true merger. However, economically speaking, the difference is of no importance as both types of deals have the same structural effects. We, therefore, consider mergers as majority acquisitions.

With regard to the terminology used, we will in fact use the terms majority acquisition and merger interchangeably and exhibit a preference for the word merger. Minority acquisitions will sometimes be referred to as minority stakes or minority holdings, while joint ventures will be used exclusively.

Graph 4 shows the evolution of the three types during the years 1986-92. Although all the types follow the same trend, it was mergers especially that showed the strongest increase in the years 1989 and 1990. Overall, mergers can be seen as the most volatile type of concentration whilst also being the most important.

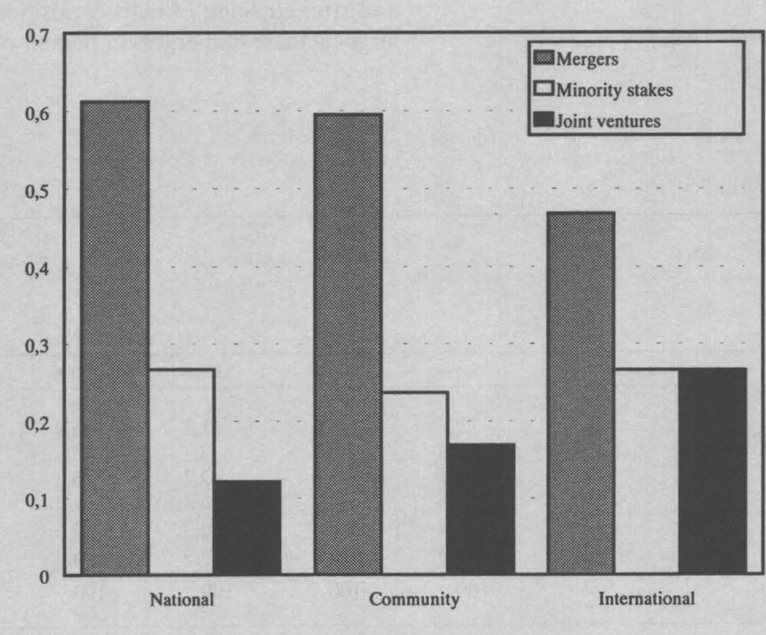
Graph 5 shows the distribution of the three types classified by national, Community-wide and international concentrations. National concentrations are defined as concentrations between firms of the same nationality. Although classified as national, their effects, however, could cross national borders and influence the whole Community. Concentrations are classified as Community-wide concentrations when the firms involved are from different national origins, but all belong to the Community. Lastly, international operations are those concentrations where at least one non-Community firm is involved. The classifications are, therefore, mutually exclusive. The graph shows the average distribution during the period 1986-92. During this period the distribution by type of M&A at national and Community levels was very stable. Conversely, the distribution showed wider variation at the international level.

From Graph 5, it appears that national and Community mergers resemble each other quite closely. About a quarter of all concentrations were minority stakes, which was also true for international concentrations. However, a difference is discernible for joint ventures. They take a 25% share of international concentrations, but only an average of 12% for purely national deals. For concentrations at the Community level about 16% was of the joint venture type. The share of mergers in international concentrations, on the other hand, is much smaller than in the other two categories. Mergers account for more than half the concentrations at the national and Community level, but represent less than 50% internationally. This seems to imply that international concentrations tend to be less structural. An explanation for this is that joint ventures are normally embarked on by larger companies, who typically try to cooperate in specific fields, GRAPH 4: Number of mergers, minority stakes and joint ventures with an effect in the Community



Source: DOME.

GRAPH 5: Distribution of national, Community and international deals (1986-92)



Source: DOME.

such as R&D and distribution networks. These larger companies do not seek full integration, preferring looser arrangements such as joint ventures. Potential partners exhibiting complementary interests are normally found across national borders and joint ventures have, therefore, a tendency to be more internationally oriented.

2.1.2.4. Firms' motives

It is interesting to see what, in practice, companies' real motives are for engaging in merger activity. Economic theory gives us many rationales for concentrations, but does not give any indication about their importance for firms in practice.

The graphs presented here are taken from the annual Competition Reports.[1] They are based on public statements about the transactions. Whether these statements represent true intentions is hard to verify. Many economists point to the large percentage of mergers that fail and try to explain this as being due to the striving by management to achieve objectives other than those that serve shareholders' interests. However, such objectives are unlikely to be publicly avowed.

Taking the figures at face value, interesting conclusions can be drawn. Table 1 shows the evolution of the main motives for merger activity. Graph 6 compares motives for the years 1985-86 and the years 1991-92. Major differences are apparent. While rationalization and synergy accounted for almost half the motivations given for merger activity in the period 1985-86, they only represented 16% in 1991-92. Instead, for 1991-92, the strengthening of a market position is the main motive, followed by expansion.

Rationalization of production and more intense synergies mainly seem to have been realized in the period 1985 to 1988. The current mergers have become more aggressive, focusing on market positions and expansion. From a policy viewpoint this change increases the need for adequate antitrust legislation in general, and merger regulations in particular, so as to safeguard healthy competition.

General expectations regarding the single market programme are also confirmed by the graphs. One of the expected effects of the programme was that the increased competition brought about by the market would force firms to concentrate on their core businesses. It was, therefore, expected that firms would increasingly specialize and divest themselves of activities lying outside their core. This is supported by Graph 6. In 1985-86 diversification was still one of the three main motives for merger activity (17,6%). However, its role subsequently decreased dramatically and accounted for only 2,1% in 1991-92.

The second effect of the internal market on M&A behaviour is the need for firms to penetrate further into the Community's single market rather than concentrating on domestic markets. The single market removes barriers and cross-border penetration becomes more attractive. Firms will take advantage of these relaxed conditions and expand their activities. A readiness to seize opportunities for expansion and strengthening of market position can be seen from the large increase in mergers in pursuit of this goal.

[1] The Commission's *Report on Competition Policy*.

Table 1

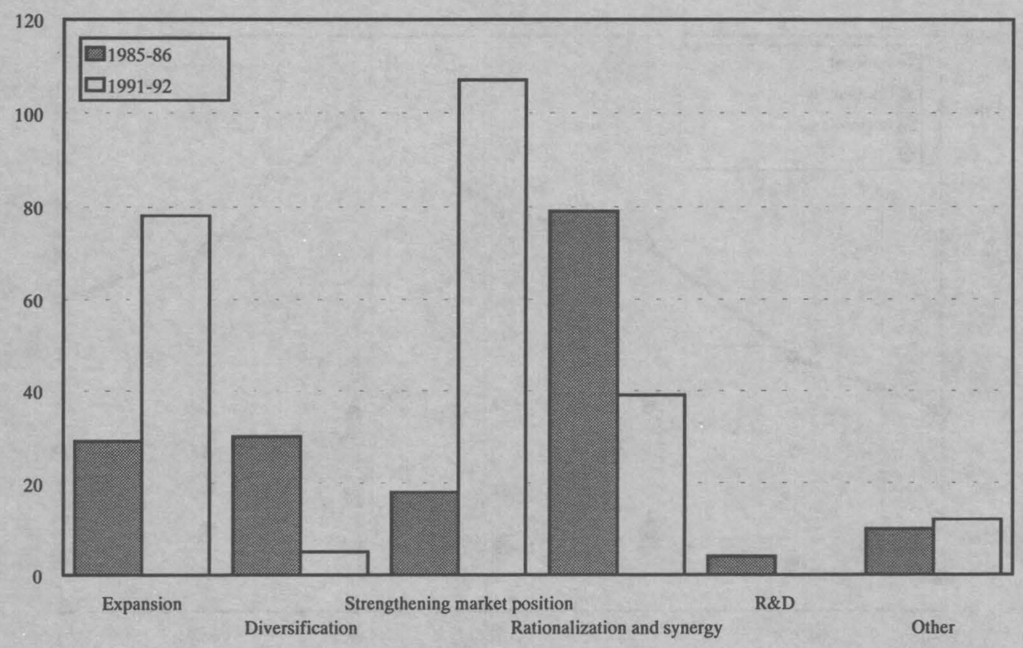
Firms' motives

(%)

	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
Expansion	17,1	22,1	19,6	31,3	26,9	27,7	32,4
Diversification	17,6	5,8	8,3	7,1	3,0	2,8	2,1
Strengthening market position	10,6	11,5	25,4	42,2	45,3	48,2	44,4
Rationalization and synergies	46,5	42,0	34,4	14,4	17,7	13,3	16,2
R&D	2,4	5,3	0,7	0,0	0,6	0,0	0,0
Other	5,9	13,3	11,6	4,9	6,4	8,0	5,0
	100	100	100	100	100	100	100

Source: DOME.

GRAPH 6: **Motives for mergers**



Source: DOME.

2.1.2.5. Geographical spread of concentrations

Cross-border transactions are more dependent on economic activity than domestic ones. To examine this, it is illustrative to classify the bulk of Community-wide mergers into three groups. Such a classification has already been used before, when we examined the different types of operations. Here we deepen the analysis and take a closer look at the origin of M&A activity.

The three groups are specified as follows. First of all, there is the group comprising pure national deals. This group consists of all those deals where the firms involved originated from just one Member State. Although most of these concentrations have spillover effects influencing the Community as a whole, their main impact is at the national level. The spillover effects, however, will become more important in the future, as the different Community markets integrate further.

The second type groups the concentrations that take place at the Community level, meaning that the firms involved were all Community-based, but originated from different Member States. Seen from a Community perspective, these deals are the most interesting.

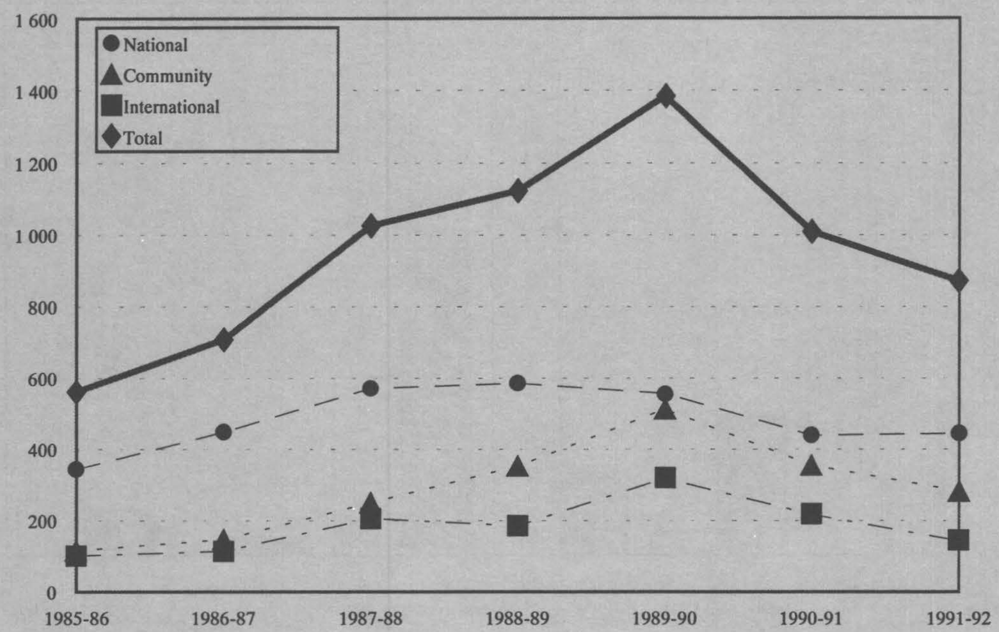
The remaining set of concentrations are ranged under the heading 'international concentrations'. Concentrations where at least one of the participating firms came from outside the Community belong to this group. The three groups together, therefore, comprise all documented concentrations and are mutually exclusive.

Graph 7 plots the evolution of the different types of concentrations. The first striking feature is that the 1990s peak is accounted for by a large increase in Community and international deals. Conversely, the number of national concentrations dropped that year, following their peak the previous year. The graph, therefore, shows that non-national M&A activity lags behind national activity.

It is tempting to explain this by pointing once again to the single market programme. After all, in advance of the single market, firms could be expected to try to reorganize their structure beginning with national markets before turning towards the Community.

This conjecture is fully supported by Graph 7 as well as by Table 2, where we see a more than proportional increase in M&A activity at national level until 1987. After that the

GRAPH 7: Number of M&As by geographical spread



Source: DOME.

Table 2

Geographical distribution of concentrations

	1985-86	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
National	61	63	56	52	40	43	51
Community	21	21	24	31	37	35	32
International	18	16	20	16	23	22	17
Total	100	100	100	100	100	100	100

Source: DOME.

share of national deals declines, while that of non-national deals increases, peaking in 1990.

Graph 7 also shows that the level of Community concentrations remained relatively high until 1991-92. This feature is re-emphasized in Table 2, where we see that the share of Community concentrations during the six years increased from 21 to 32%, peaking at 37% in 1990.

However, since no stabilization period has yet occurred, it is unclear if the higher share of Community concentrations is structural, as maintained in the Twenty-second Competition Report.

A close examination of Graph 7 clearly reveals that the number of non-national deals fluctuates strongly in line with the total number of deals, indicating that a link exists between the total number of concentrations and the share of non-national concentrations. A simple linear regression, with the total number of concentrations taken as an explanatory variable for the share of non-national deals,[1] shows a strong statistical link between the two variables,[2] leading to the conclusion that no structural change has taken place. The implication is that Community and international concentrations are much more volatile than national-level deals. As soon as the total number of concentrations goes up, the share of non-national deals increases as well. Community and international deals show a much more dynamic evolution than national deals.

This behaviour can be explained as follows. International and Community concentrations involve, in general, larger deals than national concentrations. If we accept that general M&A activity is influenced by economic conditions, as is maintained by many empirical studies,[3] then it is clear that this must be especially true for the largest deals. In absolute terms, the largest deals are more important and incorporate a larger risk for the companies involved. They will, therefore, be less quickly undertaken when economic conditions are less optimistic. This explains the rather high volatility of the number of international and Community concentrations since, according to the first assumption, they comprise the largest deals. As a consequence, a positive link exists between total M&A activity and the share represented by Community and international concentrations. The apparent indications of structural changes are, therefore, too weak to draw any firm conclusions.

2.1.2.6. The effect of the single market programme

With the single market programme, the anticipated increase of competition has forced European firms to restructure and to concentrate on their core businesses, while third countries have tried to get a foothold in what they feared would become a 'fortress Europe'.

The need for European firms to concentrate on their core businesses implies two things. First of all, divestments of operations lying outside the core activity in which firms do not possess a comparative advantage are needed. These divestments can be considered as sell-offs and increase the number of financial operations on the M&A markets. The second effect for European firms is the need to expand Community-wide operations. As a result of the single market programme, Community markets will slowly merge into one. This obviously extends to firms the possibility of selling their domestic production abroad. However, many firms find that internal growth is insufficient to keep pace with changes in market size. Hence, firms turn their attention to external growth, but possibilities are also limited on national markets. Larger Community firms, therefore, need to be present in the different Member States, otherwise they will be unnecessarily forgoing demand. The easiest and quickest way to attain such a presence is by acquiring similar firms or looking for possible partners in other Member States, rather than slowly building up market position through internal expansion of operations. The peak in the period 1989-90 and its following decline can, therefore, be adequately explained by the single market programme.

This is also confirmed by the fact that a number of enterprises are turning their attention more often towards Europe, as far as cross-border acquisitions are concerned. The example of the United Kingdom (see Table 3) turning towards the Community at the expense of the USA is illustrative: while showing a ratio of 3 (the reciprocal of 0,3 in the table) in favour of the USA in 1986, UK firms completely changed their focus in subsequent years, thus leading to a ratio of 2 in favour of the Community in 1992.

For enterprises outside the Community the growing importance of the single market can be explained by a new reality: the removal of barriers means that one site is enough for developing business throughout the Community. A remarkable element is that the general evolution in acquisitions of EC enterprises by firms from non-EC countries follows the

[1] Share of non-national deals = b.total number of deals + e.

[2] The OLS regression without intercept resulted in an R^2 of 0,9758 and a very significant t-value of 15,5.

[3] See for instance, Reid, S. R. (1968), *Mergers, managers and the economy*, McGraw-Hill, New York; Geroski, P. A. (1984), 'On the relationship between aggregate merger activity and the stock market', *European Economic Review*, 25, pp. 223-233; Melicher, R. W, Ledolter, J. and D'Antonio, L. J. (1983), 'A time-series analysis of aggregate merger activity', *Review of Economics and Statistics*, 65, pp. 423-430.

Table 3

Number of cross-border UK acquisitions

	1986	1987	1988	1989	1990	1991	1992
Target = EC	63	129	239	370	290	173	163
Target = US	214	258	379	258	163	90	85
Ratio	0,3	0,5	0,6	1,4	1,8	1,9	1,9

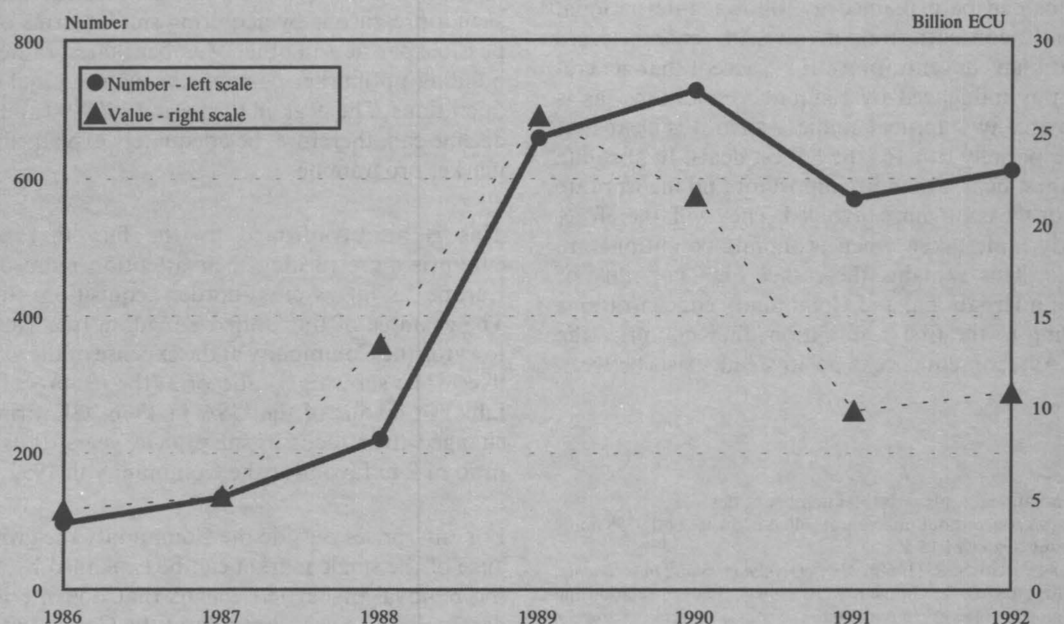
Source: Amdata.

same trend as that of acquisitions within the Community. Graph 8 shows that the number of deals involving non-EC firms peaked in 1990, whereas their values were highest in 1989. The trends are more like those of larger deals.

Another effect could be slowly weakening historical ties between third countries and certain Member States in favour of the Community country in which entry is easiest.

Significantly, during the evolution of merger activity in the USA during the same period, the peaks of domestic acquisitions do not occur at the same time as in the Community. Nor do they occur with the same lag behind economic activity. This reinforces the conclusion that the increase in numbers of M&As has been generated by the creation of the single market.

GRAPH 8: Acquisition of EC enterprises by non-EC enterprises



Source : Amdata.

2.2. Features over the period 1990-92

2.2.1. Country specific analysis

2.2.1.1. Relative importance of Member States

Graph 9 shows the cross-border activities of the Member States. It becomes clear that amongst the largest Member States, France and the United Kingdom are the most active bidders. In 1990-92, France was the leading acquirer with a share of 27,6% in total cross-border Community mergers. The UK followed closely with a share of 23,8%, after which there is a large gap before Germany (13,4%) and the Netherlands (10,7%) take third and fourth place (see Table 4).

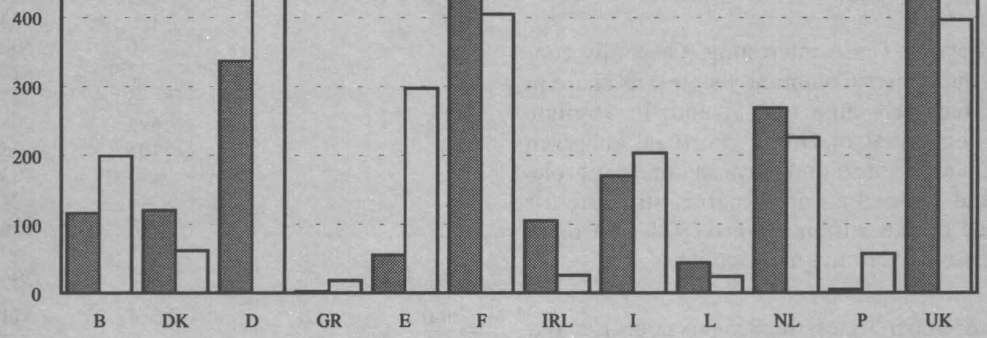
The strong position of France and the UK is not surprising. They are the two Member States with the most developed national take-over markets and, therefore, with companies most experienced in this activity. What is surprising is that from 1990 to 1992 France was more active than the UK. Historically, it has always been the UK which has led the Community in M&A activity. However, the recent recession in the UK must have had a depressing effect on its cross-border M&A activity, allowing France to take over the UK's lead position. Germany's weak position is explained by two factors. Firstly, SMEs, often family enterprises, are important in its economic structure and this leads to a preference for internal growth. Secondly, external growth was largely domestic because of the achievement of German unification during the period under review.

France and the UK are also often targeted. It is, however, Germany that has been the most targeted Member State during the period 1990-92. Again, this is easily explained by the privatization process in former East Germany.

Examining further the relative importance of the Member States, it becomes apparent that the Mediterranean countries are only weakly represented. Relating M&A activity to GDP (see Table 4), activity in Greece, Italy, Portugal and Spain is well below what could be expected.

In the cases of the three poorer countries, Greece, Portugal and Spain, this can be generally explained by a shortage of resources sufficient to allow their firms to engage in take-over activity. Another reason is to be found in the significant growth rates of these countries. This has meant that their

GRAPH 9: Number of cross-border deals by country (1990-92)



Source: Amdata.

Table 4

Share of cross-border acquisitions by Member States, 1990-92

(%)

	As bidder	As target	Relative GDP
B	4,6	7,9	3,2
DK	4,8	2,5	2,2
D	13,4	23,9	24,7
GR	0,1	0,7	1,1
E	2,2	11,8	8,2
F	27,6	16,1	19,8
IRL	4,2	1,0	0,7
I	6,8	8,1	18,1
L	1,8	1,0	0,1
NL	10,7	9,0	4,6
P	0,2	2,3	1,0
UK	23,8	15,8	16,2
Total	100,0	100,0	100,0

Source: Amdata (excluding multinational operators) and Eurostat.

domestic markets offer interesting opportunities for both internal growth and take-over activity. This is especially discernible in Spain. The graphs make clear that Spain is a preferred target for other Member States, whilst Spanish firms acquire relatively few firms in the rest of the Community.

Italy is a special case, mainly because its general economic structure dissuades take-over activity. With only a few large private firms, most larger Italian companies are State-owned. Furthermore, smaller firms generally have strong family ties. Italian firms, therefore, do not change hands as easily as those in the northern part of the Community, where the majority of firms are private and often quoted on stock markets.

The position of Ireland is also interesting. Generally considered as one of the poorer Community states, its share in M&A activity is relatively high (4,2%) and, in absolute numbers, is well above that of Greece, Portugal and even Spain. Again company organization plays an important role. Historically, Ireland has had an open market structure for firms as is reflected by the existence, since 1978, of a regulation on mergers, take-overs and monopolies.

The other smaller Member States, the Benelux countries and Denmark, also show a higher activity than could be expected from their GDP.

2.2.1.2. Net activity

Since M&A activity represents structural changes in the organization of markets, it is illustrative to look at the net balance of M&A activity between Member States. Countries showing a surplus on acquisitions tend to increase their influence on Community markets, whilst the influence of Member States exhibiting a deficit in M&A activity is reduced. Table 5 shows the general situation, while Table 6 describes the tendencies country by country.

From Table 5 it becomes clear that France and the UK have been the largest net acquirers within the Community. As already explained, this reflects the countries' comparative advantage in M&A experience. From Table 6 we see that the UK concentrated its acquisitions on Germany and France. France displayed a more open strategy and acquired a large number of companies in Germany, Spain, the UK and Italy. It is interesting to note that cross-country acquisitions between France and the UK were biased in favour of the UK by 17 acquisitions.

Surprising, once again, is Ireland's net activity. It undertook nearly four times as many take-overs in the Community than the number of times it has been targeted. Its cross-border Community acquisitions mainly took place in the UK (68%).

On the other hand, Germany and Spain show large deficits in merger activity. Both countries have been targeted more

Table 5

Net balance of acquisitions in number of M&As, 1990-92

	Bidder	Target	Net
B	116	199	− 83
DK	120	62	58
D	336	602	− 266
GR	2	18	− 16
E	55	297	− 242
F	695	404	291
IRL	105	26	79
I	170	203	− 33
L	44	24	20
NL	268	226	42
P	5	57	− 52
UK	598	396	202
Total	2 514	2 514	

Source: Amdata (excluding multinational operators).

Table 6

Breakdown of M&A operations by country, 1990-92

Bidder/target	B	DK	D	GR	E	F	IRL	I	L	NL	P	UK	Multinational	Total	Cross-border
B	184	1	31	1	4	39		4	10	16		10	1	301	117
DK	3	522	28	1	7	13	1	2		14	4	47	1	643	121
D	16	23	2 897	2	26	92	1	39	5	47	8	77	12	3 245	348
GR				7		1		1						9	2
E	2		6		299	14		5			18	10	3	357	58
F	74	9	190	4	132	1 884	6	100	4	39	19	118	16	2 595	711
IRL			10		4	6	72	2		11		72	1	178	106
I	6	4	32	5	33	60		775	2	6	2	20	2	947	172
L	6		11		3	13		5	1	3	1	2	1	46	45
NL	49	11	101	2	24	31		10		646		40	2	916	270
P					5						7			12	5
UK	43	14	193	3	59	135	18	35	3	90	5	3 190	28	3 816	626
Multinational	5	5	40	3	15	29	1	16		16	4	12		146	146
Total	388	589	3 539	28	611	2 317	99	994	25	888	68	3 598	67	13 211	
Cross-border	204	67	642	21	312	433	27	219	24	242	61	408	67		2 727
Austria	2		48		4	1		6		2		2			
Finland	4	13	40		9	13		4		10	3	22			
Japan	6	3	38		10	20		8		17		56			
Norway	1	13	5		6	3	1			3		15			
Sweden	16	64	69		21	25	2	21		28	1	40			
Switzerland	8	5	192		12	50	2	22		17	2	23			
USA	13	17	226	4	30	86	4	34		42	2	158			
Total	50	115	618	4	92	198	9	95		119	8	316			
Grand total	438	704	4 157	32	703	2 515	108	1 089	25	1 007	76	3 914	67		

Source: Amdata.

often than they have engaged in cross-border M&A activity, as can be seen in the last column of Table 5.

For Germany this can be explained by the generally negative attitude towards take-over activity in addition to the family structure of many enterprises. Unlike the UK, Germany possesses a traditionally closed market to take-overs — although the market is in a process of opening due to unification. The tough German merger regulations can thus be seen as a reflection of this attitude.

A secondary reason for low cross-border merger activity was the privatization process of companies in former East Germany. This had the effect of encouraging German companies to focus more on the internal take-over market. The relative importance of German cross-border activity, therefore, decreased. On the other hand, the privatization process increased other Member States' interest in Germany. These two effects, therefore, caused a large deficit in merger activity.

Brief reference has already been made to Spain's situation. Spanish companies simply do not possess the resources for cross-border acquisitions. The country is, therefore, mainly targeted by Member States that do have resources, such as France, the UK, Italy, Germany and the Netherlands. The same is true for Greece and Portugal. Table 5 shows that both countries have been targeted many times more than they acquired.

2.2.1.3. Effect of German unification on Community M&A activity

German unification, finalized on 3 October 1990, has had a strong impact on the Community. The inefficient planned economy in the East has had to make way for a market-oriented one, in which market forces play a leading role. An important stage in the economy's reorientation was the privatization of State-owned companies in former East Germany. This privatization process has had an important impact on M&A activity in the Community. Without this 'sale of the century', the decline in the number of M&A transactions from 1990 to 1992 would have been even larger.

The Treuhandanstalt was given responsibility for the privatization process. This organization became the owner of 8 000 industrial companies and 20 000 shops and service outlets. Most of the shops and service outlets were privatized within one year.

More than 5 000 industrial firms have been privatized. Most were acquired by German companies, while only a small number of companies were bought by non-German Community firms. At the beginning of the privatization process hardly any foreign investors seemed interested. Up to mid-1993, only 8% of the 8 000 industrial companies under the Treuhandanstalt had been acquired by foreign purchasers. This was often accomplished through subsidiaries already operating in Germany. Overall foreign interest, however, was obviously disappointing and not commensurate with the 15% of German capital already owned by foreigners. However, there are indications that the firms that were bought by foreign investors were larger than the average firm on sale. The number of acquisitions by non-German firms, therefore, does not truly represent the relative importance of the role that foreign investors played during the privatization process.

Table 7

Evolution of M&A activity where a German enterprise is targeted

(Index 1990 = 100)

Bidder	1990	1991	1992
B	100	100	6
DK	100	233	133
D	100	186	149
GR	—	—	—
E	100	33	66
F	100	126	74
IRL	100	60	40
I	100	118	72
L	100	800	200
NL	100	77	33
P	—	—	—
UK	100	77	46
Multinational	100	76	58
Sweden	100	92	73
Switzerland	100	127	103
USA	100	122	141
Total	100	154	121

Source: Amdata.

Table 7 shows the evolution of M&A activity in Germany, presented as an index (1990 = 100). The privatization process started in mid-1990. We do indeed see that internal activity in Germany increased sharply in 1991. In 1992 it fell back, but remained well above the level of 1990.

The involvement of non-German Community firms in German privatization differs from country to country. Germany's neighbours were especially active. Denmark (and Luxembourg) had the largest increases, maintaining in 1992 a level surpassing that of 1990 (all other Member States acquired in 1992 a smaller number of companies than in 1990). Their increased activity was especially noticeable during 1991. The situation of the Netherlands is surprising. The activity of this Member State plummeted in the years 1991 and 1992 to only 33% of its 1990 activity. The only explanation for this is that the Netherlands, possessing strong economic ties with Germany, was already buying its share of former East German companies in 1990. The UK, hit by recession, reduced its number of operations in a similar way to that of the Netherlands.

The table also presents the activity of third countries for which the absolute number of transactions is significant: Sweden, Switzerland and the USA. Sweden reduced its activity in 1991 and 1992, while Switzerland increased its number of acquisitions in 1991, returning to the 1990 level the following year. The case of the USA is interesting as it is the only country that shows increased activity in 1991 and 1992. Most probably the lag is explained by the unfamiliarity of US firms with German markets.

The main effect of German unification on the Community's M&A markets was to minimize the recorded decline in take-over activity after 1990. Since the former East German firms were mainly bought by German investors, the number of national deals has increased relative to that of non-national deals. As already maintained when discussing the spread of M&A activity, this focusing of German firms on their national market has reduced German activity abroad because resources for take-over activity are limited. Take-overs in Germany represented more than a quarter of total internal Community deals from 1990 to 1992. However, the privatization process will most probably be finished in 1993 and a reorientation of German firms towards the rest of the Community can be expected after that.

2.2.1.4. Relations with third countries

The USA is the most active third country, followed by Switzerland and Sweden. Generally, the Community's major commercial partners are present as bidders and as targets for M&A activity. Table 8 shows a ranking of the 12 main third countries involved in M&A operations with an EC enterprise. The principal difference between the two lists is that Eastern countries are more present as targets whereas Asian countries appear more as bidders.

Table 8

Twelve most active third countries in number of M&As concerning an EC enterprise, 1990-92

Third country as bidder		Third country as target	
USA	417	USA	345
Switzerland	200	Switzerland	82
Sweden	135	Hungary	59
Japan	104	Sweden	49
Finland	61	Norway	35
Austria	55	Canada	35
Australia	32	Czechoslovakia	30
Canada	31	Austria	27
Dual nationality	22	Poland	23
Hong Kong	22	Finland	21
Norway	21	Australia	21
South Africa	12	Japan	16

Source: Amdata.

During the period under consideration (1990-92) the USA was the most active third country bidder. The 417 recorded deals involving US firms represent 35% of total activity. Switzerland with 17% of the deals, and Sweden with 11% led the EFTA countries. More surprising is Finland's fifth position with 5% of all deals. Other overseas countries also played an important role with Australia, Canada, Hong Kong and South Africa all among the 12 leading countries.

Looking at third countries as targets, the USA once more comes out first with about the same share. The 345 times EC enterprises targeted US ones count for 38% of all cases. After that the targets were more evenly distributed. Indeed, Switzerland was the second preferred target with only 9%. Other EFTA countries occupy their expected place. More striking is the interest for Eastern countries. Hungary's third place with 6% is notable. Likewise, Czechoslovakia and Poland are present. Japan is also on the list of the 12 most targeted countries.

2.2.2. Sector analysis

Mergers and acquisitions structurally change market conditions. In general, M&A activity reduces the number of players in a market and increases concentration. This effect is the main concern of merger-regulating authorities, as the reduction in competitors can severely decrease effective competition. A comprehensive analysis of past concentrations in a market-based examination of M&A activity is, therefore, necessary.

However, since the definition of a market is not a trivial matter and can, in practice, only be determined after lengthy investigations, we propose here a sectoral analysis instead.

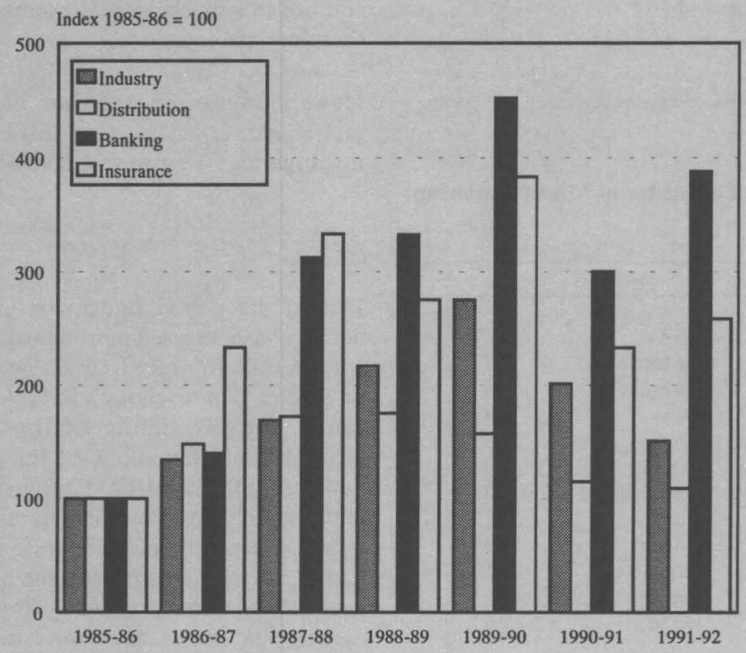
2.2.2.1. Most-active sectors

During the period under consideration (1990-92), M&A activity has increased more sharply in services than in industrial sectors. In order to examine this very general assertion in greater depth, choices have to be made about classification. The classification of firms into sectors can be rather arbitrary and this is one of the areas where discrepancies between different M&A databases arise (see Box 1). Firms, and not only large conglomerates, are often too diversified to be conveniently classified into a single sector. This problem of course increases with the level of detail. The solution generally chosen is to classify firms according to their main activity and to use a sectoral breakdown that is not too detailed.

Graph 10 shows the evolution of M&A activity in the four main sectors: industry, distribution, banking and insurance. In contrast to the distribution and industry sectors, it is the financial services sectors (banking and insurance) that have shown the largest increases in activity since 1986. Activity in these sectors has been increasing in all years except 1991. The completion of the single market has been especially important to these two sectors. Abolition of trade barriers before the completion of the single market had applied mostly to the industry sector. Services were seen as less exportable and, therefore, the existence of trade barriers in these sectors such as limited transfers of capital were not considered to have the highest priority. Hence, completion of the single market programme has had a larger impact on the services sectors, since the barriers that have been abolished last were relatively more important to these sectors. It is, consequently, not surprising that the banking and insurance sectors have exhibited a more intense restructuring in the reviewed period than manufacturing industry.

A more detailed breakdown is made in Table 9. The table ranks the 10 sectors which were targeted most during 1990-92, classified according to the NACE 2-digit code. The most active sector was business services, which also incorporates the activity of holding companies. It is not surprising that this sector heads the list, as the main activity of holding companies is the sale and purchase of companies.

GRAPH 10: Number of deals by sector



Source : DOME.

Table 9

Ten most targeted sectors during 1990-92

NACE	Description	Number
83	Business services	3 990
81	Banking and finance	1 252
47	Paper manufacture and production	893
32	Mechanical engineering	869
61	Distribution — wholesale	857
34	Electrical and electronic engineering	578
41	Food industry	527
25	Chemical industry	517
42	Sugar and sugar by-products	423
50	Construction and civil engineering	378

Source: Amdata.

Banking and finance has been the second most active sector. This is in line with the tendency already observed in the Twenty-second Competition Report that M&A activity in the financial sector has shown a strong surge in recent years, in contrast to manufacturing industry. The average deal accomplished in this sector also showed a relatively high value as compared to deals in other sectors, indicating a relatively important degree of restructuring.

The other most active sectors were mainly manufacturing sectors and wholesale distribution. Mergers and acquisitions have still mostly been taking place in relatively downstream manufacturing industry. Industries concentrating production more upstream, further away from finalized products, do not exhibit strong M&A activity. Only the chemical industry has been something of an exception.

One of the main arguments in favour of the creation of the single market was that existing gaps in industrial plant sizes between Europe and other industrialized countries would slowly disappear. European plants were considered to be too small to realize all significant economies of scale for their production. Due to secluded national markets, European firms were not able to operate at their optimal sizes, creating a competitive disadvantage *vis-à-vis* their main competitors such as the USA and Japan.[1] Opening national markets was therefore expected to generate a strong restructuring of the major EC firms, finally able to exploit all available economies of scale. Although information on aggregate output of the major firms after the completion of the single market (1993) is not available, it can be expected that the major EC firms already started their restructuring in advance. Table 10 shows the nominal growth of the top five manufacturing EC firms in each sector and Table 11 shows the C5 ratio which indicates the share of the top five industries in the value-added of the whole sector.

Although all sectors have shown a steady nominal growth of their top five firms, some increases have been rather large. In the rubber sector, the three top firms Michelin, Pirelli and Continental have grown with a remarkable speed which can only be attributed to external growth. Table 11 shows this. The C5 ratio increases from 15 to 22%. This indicates quite clearly that the sector has become more concentrated. The failed hostile take-over bid by Pirelli for Continental, which would have meant the creation of a new market leader, is an illustrative example of the high volatility and strong activity going on in the sector.

Strong reshuffling in pharmaceuticals was one anticipated effect of the single market. It was this sector especially that suffered from strong national fragmentation, due to diverging national regulations.[2] The entrance of Sanofi and the current market leader, Smithkline Beecham, into the top five in this sector were the main causes for the large increase of aggregate turnover. However, the almost 70% increase in turnover of 1986 market leader Glaxo contributed to the 8% growth of the concentration index.

A third sector that has shown a growth of over 100% for the top five firms is aerospace. Here the large increase was mainly explained by the growth of British Aerospace and Rolls Royce. While Aérospatiale constituted the largest company in this sector in 1986, it was British Aerospace that

Table 11

Share of top five EC firms in total value-added of each sector (C5 ratio)

Sector	1986	1991	Change %
Tobacco[1]	58,39	59,16	0,76
Textiles	7,71	8,24	0,54
Chemicals	42,25	41,48	-0,77
Rubber and plastic products	14,78	21,71	6,93
Construction materials	28,39	24,29	-4,11
Iron and steel	47,21	82,31	35,10
Metal goods	9,79	11,69	1,90
Electronics	33,92	31,48	-2,44
Motor vehicles and parts	55,45	56,49	1,05
Aerospace	51,24	71,97	20,72
Pharmaceuticals	19,28	27,66	8,38
Computers	34,08	33,17	-0,91
Industrial machinery	20,07	20,10	0,03
Drink	39,73	43,24	3,50
Food	16,92	20,37	3,45
Printing and publishing	19,20	19,34	0,14

Source: Dable/DG III.A.3 and VISA.
[1] Only top three firms.

Table 10

Aggregate value-added of top five EC firms in each sector

(billion ECU)

Sector	1986	1991	Change %
Tobacco[1]	17,6	22,7	+29
Textiles	6,0	7,6	+27
Chemicals	80,0	95,3	+19
Rubber and plastic products	11,2	24,8	+121
Construction materials	21,0	25,3	+20
Iron and steel	29,0	53,2	+83
Metal goods	12,6	21,9	+74
Electronics	66,7	85,4	+28
Motor vehicles and parts	110,3	167,0	+51
Aerospace	15,8	32,4	+105
Pharmaceuticals	8,4	19,7	+135
Computers	13,1	17,3	+32
Industrial machinery	34,6	46,3	+34
Drink	21,4	31,1	+45
Food	47,5	73,5	+55
Printing and publishing	11,1	17,8	+60

Source: Dable/DG III.A.3.
[1] Only top three firms.

[1] See Schwalbach, J. 'Economies of scale and intra-Community trade', economic papers, European Commission, October 1988.

[2] See also the Competition Policy Reports.

took over the lead in 1987 and generated a 1991 turnover more than twice that of Aérospatiale. Again the C5 ratio increased.

Iron and steel presented a very large increase of the C5 ratio (+35%). This is explained by the entry of VIAG AG and British Steel in the top five, while the sector's total value-added remained at the same level.

In all other sectors the growth of the five largest firms has been strong to moderate. Their concentration ratios were also rather stable. Meanwhile, comparing Table 10 with Table 9 makes it apparent that those sectors which have shown the strongest M&A activity do not match the sectors where the top five firms have grown the fastest.

The top five firms in the printing and publishing sector have, according to Table 10, exhibited growth of 60%. In contrast to the growth in sectors mentioned above, however, this growth has not been caused by new entry. The share of the top five firms in this sector has been maintained during the five years, with only a small reshuffle in ranking. Moreover, the table does not include the merger of Reed and Elsevier, creating the largest publishing group in the Community and the second largest world-wide. Also the Dutch merger between KNP, Buhrmann Tetterode and VRG[1] is not incorporated.

The activity of the French firm BSN exemplifies the take-over strategy exhibited in the food sector. Food markets are relatively mature with only a small number of new subsectors (niches), like prepared meals. Take-overs have generally been rather small, but steady. The strategies of the largest players concentrate on taking over locally well-known brands, hoping in this way to secure and strengthen their already strong positions across the Community. In this way BSN increased its turnover by 25% in 1991. According to the company's reports, the increase would only have been 4,7% without take-overs. The fact that concentration in the food industry is lower in the southern Member States than in the northern Member States[2] suggests that an increase in merger activity in these countries can be expected. That BSN's main take-over activity in 1991 took place in Spain, Italy and Greece is, therefore, hardly surprising.

M&A activity in the chemicals sector is traditionally characterized by cross-border activity.[3] Take-overs in this already highly concentrated sector are relatively sensitive from a competitive point of view. In 1989, two thirds of Community production was accounted for by the 20 largest firms. All these firms have engaged in at least some degree of M&A activity, concentrating their purchases in niche markets. Indications exist that in some of these markets, such as paint and varnish, and soap, detergents and toilet needs, effective competition has been reduced.[4] Further activity in these sectors should, therefore, be thoroughly scrutinized.

2.2.2.2. Vertical concentrations

Although vertical mergers do not lead to a more highly concentrated market in the manner of horizontal concentrations, they may, however, lead to a higher threat of the creation of market power. The possible creation of a dominant position is achieved more indirectly. Potential anti-competitive behaviour resulting from a typical vertical merger is caused by different factors from those attached to horizontal mergers. For a vertical merger, considerations of market-foreclosure, amongst others, play the most important role for antitrust authorities. Through monopolizing (foreclosing) an upstream market a firm can gain an advantage in production costs. It charges high external prices to competitors for the inputs they need, while keeping internal prices low. Competitors are faced with higher production costs, since they buy their inputs at higher prices than the backwards integrated firm.

Classifying a merger as horizontal depends crucially on the rather complex definition in economics of the relevant market. To circumvent the problem of market definition we examine here mergers by sectors classified under the NACE code. A merger is considered to be horizontal when it takes place in the same sector. The NACE code allows for different degrees of sophistication, depending on the number of digits used.

Using the above definition for a horizontal merger we conclude from Table 12 that about 41% of mergers are horizontal using the 4-digit code, increasing to 47% using the 3-digit NACE code. Non-horizontal mergers make up more than half the cases. There is a slight increase in the number of horizontal mergers from 1991 to 1992, but this increase is hardly significant. Concentrating on a 1-digit classification we still find that 36% of deals take place between different sectors: non-horizontal mergers, i.e. vertical and conglomerate concentrations, therefore play an important role in overall merger activity.

1 Approved by the Commission in Case IV/M.0291.

2 See *Twenty-first Report on Competition Policy*, 1991, p. 421.

3 See *Twenty-first Report on Competition Policy*, 1991, p. 420.

4 See *Twenty-first Report on Competition Policy*.

Table 12

Horizontal mergers during 1991-92

Based on	Year	Number	%
4-digit NACE code	1991	1814	40,5
	1992	1618	41,3
	Total	3432	40,9
3-digit NACE code	1991	2057	45,9
	1992	1881	48,0
	Total	3938	46,9

Source: Amdata.

In the following section we exclude the banking and financial sector (NACE group 8) because 40% of all non-horizontal mergers took place in it due to purchases by holding companies and other non-banking financial institutions.[1] Vertical mergers can be identified in other sectors.

Acquisitions made by the production and distribution of electricity sector were mostly made in two other sectors. Firstly, 22 acquisitions were made in the refuse disposal, street cleaning and fumigation sector. This is a somewhat surprising type of acquisition for the electricity industry and most likely caused by increased environmental awareness leading to the use of waste for producing energy. Secondly, 14 acquisitions were made in the professional and technical services sector, while 10 deals took place in the distribution sector for wholesale fuels and ores. The first and third sort of acquisitions can be classified as upstream and could raise doubts with regard to possible market foreclosure.

Another example can be found in the fuels and ores distribution sector, which is not only a sector performing many cross-sectoral acquisitions but is also a target for many acquisitions from other sectors. This is consequential and could indicate that long chains of companies are being created covering all phases of the manufacturing process from raw material to finished product. The threat of market foreclosure to firms that are not vertically integrated is, therefore, further increased.

2.2.2.3. Sectoral propensity by country

Another method for handling sectoral analysis is to give a picture of dynamic adjustment. The point is to determine which countries have a purchase or sale propensity in particular sectors. In this respect, an indicator was constructed that is consistent with the one used by Buigues et al.[2] The ratios:

M&A activity of a country/total M&A activity (1)
and
M&A activity of a country in a sector/total M&A activity in the sector (2)

were computed over the period 1990-92 in number as well as in value for each EC country considered as bidder and as target.

A country is said to have a purchase propensity in a specific sector when, considering the country as bidder, the ratios (2)/(1) are greater than one, both in number of operations and in value of operations. Conversely, a country has a sale propensity if the same ratios are greater than 1, when the country is considered as target.

Table 13 (part A) shows the indicators for sectoral breakdown based on the 1-digit NACE code. Although it gives a good overview, this sectoral breakdown is too rough to allow deep country analysis. Nevertheless, some indications can be drawn. First, the number of countries by sector showing purchase or sale propensity are balanced. One notable exception is the sector of 'distribution, hotel and catering' for which five countries have a purchase propensity and none a sale propensity. At this low level of disaggregation, the most active sectors are 'banking, insurance and business services' and 'metals, minerals and chemicals'.

Table 13 (part B) shows the indicators for a set of meaningful 2-digit NACE code sectors. At this level of disaggregation the picture may change. For example, Belgium shows a purchase propensity in the food industry and in banking and finance which was not the case in any sector at the 1-digit level. More generally, one can point to some predictable results, such as purchase propensity in chemicals for Germany or distribution for the Netherlands. But since the process is still ongoing, it is too early to give definitive answers to the questions raised.

2.2.3. M&As and EC Merger Regulation

M&A activity has to be controlled in order to avoid competition distortions. Today a concentration has a Community dimension if all of the following three thresholds are met:

[1] Based on 4-digit code. For horizontal mergers defined according to the 3-digit code, 25% took place in NACE group 8.

[2] Buigues, P., Ilzkovitz, F., Lebrun, J.-F. and Sapir, A. (1994), 'Market services and European integration — the challenges for the 1990s', *European Economy and Social Europe*, Reports and studies No 3-1993.

Table 13

Sectoral propensity by country, 1990-92
P: purchase propensity; S: sale propensity

NACE	Sector	B	DK	D	GR	E	F	IRL	I	L	NL	P	UK
							Part A: 1-digit NACE code						
0	Agriculture/forestry/fishing			S			P						
1	Energy and water supply industry											S	P/S
2	Metals/minerals/chemicals	S		P/S	S	S				P		P	
3	Metal goods/engineering/ vehicles		S	P					P/S				S
4	Other manufacturing industries		P				S	P/S	S	P			
5	Construction		P/S	S		P/S	P						
6	Distribution/hotels/catering				P			P			P	P	P
7	Transport and communication	S		P		P							S
8	Banking/insurance/business services	S				S	P	S		P/S	P	P/S	
9	Other services		P				P		P				S
							Part B: 2-digit NACE code						
22	Metal manufacturing	S		S		P/S			P	P			
25	Chemical industry			P		S	S		S				P
32	Mechanical engineering		P/S	P					S				P
34	Electrical and electronic engineering						P		S				
35	Motor vehicles and parts		S	P		S	S		P				
41	Food industry	P	P/S			P		P/S	S		S		P
47	Paper manufacture and products		P				S	P		P	P/S		
61	Distribution — wholesale		P	P	P			P/S			P		P/S
66	Hotels and catering			S			P	P			S		P
81	Banking and finance	P				S	P	P/S					
82	Insurance	P/S					P	S			S		

Source: Amdata.

(i) the total turnover of all enterprises involved is more than ECU 5 000 million (global threshold); (ii) at least two enterprises concerned have a Community-wide turnover of more than ECU 250 million (*de minimis* threshold); and (iii) at least one third of the Community-wide turnover of all enterprises concerned is achieved outside one Member State (two-thirds rule).

However, despite these administrative criteria, there is still a risk that some mergers will not be scrutinized even though, from an economic point of view, they have a Community dimension.

2.2.3.1. The size of industrial sectors in the Community

Using turnover thresholds to define the Community dimension has the advantage of providing a rather straightforward delimitation of Community and national competence. This is of value to all parties involved in a concentration case as it provides a large extent of legal security. But it has been pointed out[1] that, from an economic point of view, it has the disadvantage of not taking into account that Community industrial sectors are of quite different sizes.

1 Jacquemin, A., Buigues, P. and Ilzkovitz, F. (1989), 'Horizontal mergers and competition policy in the European Community', *European Economy* No 40, May, p. 50.

At the 3-digit NACE level of disaggregation total Community-wide sales in 1992 ranged from ECU 245 billion (manufacture and assembly of motor vehicles) to ECU 0,6 billion (manufacture of furs and fur goods).[1] Out of 120 3-digit NACE industrial sectors, 18 had a Community turnover of less than ECU 5 billion in 1992, seven of which were even below ECU 2 billion (see Table 14). In those sectors, even a Community-wide monopoly would not be of Community competence if it were held by a specialized enterprise not having significant sales in other sectors as well. A few of these sectors have been identified as particularly affected by the completion of the internal market and/or as already highly concentrated (see below).

In general, uniform turnover thresholds are biased towards assigning too many concentrations to the Community which involve large conglomerate enterprises and possibly too few concentrations of smaller specialized enterprises. The theoretically most convincing solution would be to abandon uniform turnover thresholds in favour of relative thresholds based on shares in the Community market. This is, however, hardly practical as deciding what is the relevant market often requires in-depth case analysis. An approximation of relative thresholds could be sought by using sectorally differentiated thresholds to define a Community dimension. Such an approximation would, however, require a large number of different sectoral thresholds, which again would hardly be practical. Furthermore, the appropriate classification of a conglomerate enterprise would be a source of dispute.

As it appears therefore inevitable that in some sectors too many concentration cases, and in others too few, are assigned to the Community, the possibility of referral of cases between the Community and national authorities becomes important as a secondary corrective mechanism. The current system of referral is asymmetric in that the Commission can upon request refer a case to a Member State, but it cannot claim a case from a Member State which is below the thresholds but appears to have a Community dimension.

In the package of proposals submitted in the Commission to the Council in the first review of the Merger Regulation, certain changes to the referral procedures were envisaged. However, several Member States hesitated to introduce formal changes to the Regulation and it was decided that the possibility of threshold reduction referral procedures and other revisions should be looked at again by the end of 1996 at the latest. Consequently, no changes in this area have been introduced.

[1] *Source:* VISA-DEBA database provided by Eurostat.

Table 14

Industrial sectors in the European Community with an output of less than ECU 5 000 million in 1992

Nace code	Sector	Output (million ECU)	
4550	Manufacture of household textiles	4 657	Moderate non-tariff barriers
3165	Domestic heating appliances	4 479	
4420	Leather products, substitutes	4 052	
4650	Other wood manufacture excluding furniture	3 917	
4950	Miscellaneous manufacturing industries	3 766	
4381	Carpets from all types of fibre	3 446	
4640	Manufacture of wooden containers	3 396	
4930	Photographic and cinematographic laboratories	2 869	Moderate non-tariff barriers
4660	Cork and straw articles, brushes	2 311	
4340	Preparation of flax, hemp, ramie	2 041	
3190	Other metal workshops	2 013	
2460	Grindstones, abrasive products	1 740	
3740	Manufacture of clocks and watches	1 473	
4920	Manufacture of musical industries	1 013	
3650	Other transport equipment	935	Highly concentrated
4350	Jute industry	879	
2440	Manufacture of asbestos articles	735	Highly concentrated, weak growth, closed to international trade
4560	Manufacture of furs and fur goods	571	

Source: Eurostat, VISA-DEBA database.

2.2.3.2. Concentrations in sensitive sectors

Without examining concentrations on a case-by-case basis, it is impossible to assess precisely whether there is a detrimental effect on competition in the Community. Nevertheless, the risk may be higher in particular sectors. Therefore, concentrations were examined in three groups of potentially sensitive industrial sectors.[1]

The first two groups have been identified in a 1989 study[2] by DG II as industries in which there is a danger of competition reduction. Industries in the first group are characterized by weak demand growth (typically mature or declining markets), and are fairly closed to international trade. Entry barriers have to be considered high. Economies of scale are either modest or tend to act as entry barriers, and the technology is relatively static. There is a considerable risk of monopolization of closed markets. Examples are the cement industry, the tyre industry or the tobacco industry (for the full composition of the three groups see Table 15).

The second group of sensitive sectors was heavily fragmented prior to the completion of the internal market.[3] National champions often dominated. The advent of the single market should lead to restructuring and significant merger activity. Care must be exercised to prevent the monopoly positions that existed in many Member States being replaced by tight oligopolies on the whole Community market. This second group includes industries heavily dependent on the public sector (boiler-making, heavy electrical plant, railway equipment and shipbuilding) and parts of the foods and drinks industry.

A third group of sectors where concentrations would require particular attention are those which are already rather concentrated at the Community level. Unfortunately, there are few statistics on sectoral concentration in the Community. Lyons and Matraves present first results of a data collection they undertook in the context of a SPES project on the Europeanization of industry.[4] Very provisionally they identify NACE 3-digit industrial sectors[5] having a CR5 superior to 40%[6] at the Community level in 1987 (see Table 15).

1 Manufacturing industries at the 3-digit NACE level.

2 Jacquemin, A., Buigues, P. and Ilzkovitz, F. (1989), op. cit.

3 Buigues, P., Ilzkovitz, F. and Lebrun, J.-F. (1990), 'The impact of the internal market by industrial sector: the challenge for the Member States', *European Economy*, special edition.

4 Lyons, B. R. and Matraves, C. A. (1992), 'Industrial concentration in the Community', paper presented to the SPES Evaluation Conference in Florence, 27 November.

5 Out of 88 manufacturing industries at the 3-digit NACE level.

6 That is a cumulative market share of the five largest enterprises exceeding 40%.

Table 15

Industries sensitive to mergers

Group	Industry	Sectors in NACE code
1. Weak growth and closed to international trade	Building materials	241/242/243/244/245
	Metal goods	221/222/224
	Paints and varnishes	255
	Furniture	467
	Paper goods	471/472/473
	Rubber goods	481
	Tobacco	429
2. High barriers to trade within the Community	Boiler-making	315
	Heavy electrical plant	342
	Railway equipment	362
	Shipbuilding	361
	Some food industries	417/421/425/428
	Beer	427
3. Highly concentrated	Steel tubes	222
	Asbestos	244
	Other chemical products	259
	Man-made fibres	260
	Office machinery	330
	Batteries/accumulators	343
	Telecommunications	344
	Domestic electric	346
	Electric lamps	347
	Motor vehicles	351
	Railway equipment	362
	Aerospace equipment	364
	Transport equipment	365
	Optical instruments	373
	Cocoa, chocolate	421
	Tobacco	429
	Rubber products	481

Sources: For Groups 1 and 2: Jacquemin, A., Buigues, P. and Ilzkovitz, F. 'Horizontal mergers and competition policy in the European Community' in: *European Economy* No 40, May 1989. For Group 3: Lyons, B. R. and Matraves, C. A. 'Industrial concentration in the EC', paper presented to the SPES Evaluation Conference in Florence, 27 November 1992.

In all three groups of sensitive sectors Amdata identifies a number of concentrations since 1991. Table 16 presents those involving at least one Community enterprise having a combined total turnover of more than ECU 2 billion. Out of 15 operations only two came under Community control. Thus an important part of internal market restructuring which may affect competition in the Community has not been reviewed at the Community level.

2.2.3.3. The size of the transactions

A different indicator of the magnitude of the economic effects of a concentration is the size of the transaction. As

Table 16

Mergers and acquisitions in sensitive sectors

(million ECU)

Firms	Turnover	Sectors	Aggregate turnovers
Mergers and acquisitions in Group 1 (Group 1: Weak growth of demand, closed to international trade)			
Usinor Sacilor SA (F)	13 632,2	2210	14 040,17
Ancofer Feinstahl GmbH (D) (53,5%)	408,0	2210	
Hanson plc (UK)	10 189,5	2410	13 472,94
Beazer plc (UK)	3 283,5	2410	
ARJO Wiggins Appleton plc (UK)	2 156,7	4710	2 283,3
BUHL Papierfabriken GmbH & Co. KG, Gebrueder (D)	126,6	4710	
Usinor Sacilor SA (F)	14 598,4	2210	14 884,08
Clabecq (B) (majority %)	285,7	2210	
Papierwerke Waldhof Aschaffeenburg AG (D)	2 238,9	4710	2 478,94
Matussière et Forest (F) (majority %)	240,0	4710	
Redland plc (UK)	2 292,4	2410	3 352,67
Steetley plc (UK)	1 060,3	2410	
Cookson Group plc (UK)	2 100,1	2247	2 264,96
Stern Leach Company (USA) (50%)	164,8	2247	
RMC Group plc (UK)	3 732,0	2437	3 950,54
YTONG AG (D) (52,2%)	218,6	2437	
Mergers and acquisitions in Group 2 (Group 2: Sectors heavily protected by Member States)			
ABB Asea Brown Boveri Ltd (CH)	14 612,7	3420	14 802,92
Automatisierungsanlagen Cottbus (D)	190,3	3420	
Guinness plc (UK)	4 394,3	4270	4 502,68
Union Cervecera SA (E)	108,4	4270	
Cadbury Schweppes plc (UK)	4 518,1	4283	4 622,82
AGUAS Minerales SA de CV (MEX)	104,7	4283	
Pepsico Inc. (USA)	15 333,1	4283	15 444,54
KAS SA (E)	111,4	4283	Notified: M289
Pepsico Inc. (USA)	15 334,7	4283	15 816,28
KNORR Elorza SA (E) (70%)	481,6	4283	
Mergers and acquisitions in Group 3 (Group 3: Highly concentrated sectors)			
Digital Equipment Corporation (USA)	11 088,1	3302	11 953,01
Philips NV (NET) (Computer division)	864,9	3302	Notified: M129
Electrolux AB (S)	82 400	3460	82 618,68
Seleco SpA (I)	218,7	3460	

Source: Amdata.

the size of the transaction corresponds to the value of the assets for which ownership changes, it provides a first indication of a concentration's importance in terms of structural change. However, the thresholds of the Merger Regulation are based on the turnover of the companies involved and this creates the problem that, in the absence of agreement to introduce formal changes, after the first review of the Merger Regulation, small joint ventures by big companies still fall within the Community's jurisdiction. The Commission nevertheless has stated its intention to accept substantially reduced notifications for minor joint ventures or for those which have no direct or indirect effects on markets in the Community. Suggested solutions include an additional special *de minimis* threshold for concentrative joint ventures or the use of Article 9.[1]

More difficult is the opposite case, when big transactions may fall outside Community competence because the turnover of the companies involved does not meet the thresholds. A review of the largest transactions since 1991 involving at least one Community firm shows that this is indeed a significant problem (see Table 17). Out of 47 (43, if minority stakes are excluded) concentrations with a value of more than ECU 500 million, only 8 (17% or 19%, disregarding minority stakes) have been notified to the Commission. Amongst the largest transactions which were not notified in 1992, Reed(UK)/Elsevier(NL),[2] Powergen(UK)/Mitteldeutsche Braunkohle(D), Italmobiliare(I)/Ciments Français(F) and National Power(UK)/Electricidade(P) involved enterprises from different Member States and each had a value over ECU 1 billion. The risk of substantial cross-border effects is apparent. In all four cases a lower general turnover threshold of ECU 2 billion would have brought them under Community competence.

2.2.3.4. Thresholds as ranking criteria

Indications about the relative importance of the general threshold and the *de minimis* threshold can also be obtained from Amdata. Table 18 (part A) indicates the number of concentrations involving at least one Community enterprise which meet the respective threshold levels (minority stakes are not taken into consideration). Table 18 (part B) limits the number of cases even further to just those involving cross-border concentrations.

While none of these categories corresponds fully to the thresholds of the Merger Regulation, it would appear that the first set (part A of Table 18) overlaps largely with them. It identifies 86 concentrations with a Community dimension based on the current thresholds (ECU 5 billion and ECU 250 million) from 1991 to March 1993. This is of a similar order of magnitude to the some 120 cases to which the Merger Regulation was actually applied in that period if we take into account that some 40% of these cases concerned concentrative joint ventures which are not part of the data set. Part A of Table 18 shows that 232 cases would have surpassed the proposed lower thresholds of ECU 2 billion and ECU 100 million. In other words, 2,7 times more cases would have been notified to the Commission. This would have led to some 65 additional cases per year (90 additional cases, if a proportional increase in concentrative joint ventures can be presumed). This estimate is certainly on the high side given that the data set does not specify either Community-wide turnover or national turnover (all turnover statistics refer to overall turnover). As the size of companies declines, the probability increases that their operations are predominantly national. Application of the 'two-thirds rule' as a third criterion would therefore have reduced the increase.

The larger part of the increase in cases considered to have a Community dimension would have come from the lower *de minimis* rule: from 86 to 152 (+77%), whereas the lower general threshold by itself would have increased the number of cases to 122 (+42%).

The exercise threw up a large number of asymmetric concentrations. In the sample provided in Table 18 (part A), for example, there were 451 cases of concentrations with an aggregate turnover above ECU 5 billion where one company involved had a turnover of less than ECU 75 million. This could signal a problem about the survival of fringe competitors. A first test was undertaken on the assumption that such take-overs would be concentrated in sectors with high barriers to entry.[3] In fact, asymmetric horizontal concentrations did occur more than four times as frequently in sectors with high barriers to entry than in sectors with low barriers to entry.

[1] These solutions were considered as part of a package of measures during the Commission's first review of the Merger Regulation, but met with little support amongst the Member States (see Chapter 4).

[2] The Reed/Elsevier case is also an example of a situation where the deal value (ECU 3,8 billion) exceeds the combined turnover of the companies involved (ECU 3,3 billion).

[3] Using the classification provided by Buigues, P., Ilzkovitz, F. and Lebrun, J.-F. (1990), op. cit.

Table 17
Top European deals

From 1992 to March 1993

Acquirer	Target	Industry	Value (million ECU)	Notified
1. Hong Kong Shanghai Bank	Midland Bank	Banking	5 250,5	Yes: M.0213
2. Reed International	Elsevier	Publishing	3 840	No
3. Alcatel Alsthom	Alcatel (30%)	Telecommunications	2 685,1	No, minority stake
4. Powergen + States Power	Mitteld. Braunkohle	Mining	2 485,5	No
5. Nestlé	Perrier	Soft drinks	2 191,4	Yes: M.0190
6. Fiat	Samochodow Malolitr.	Motor vehicles	1 555,1	No
7. Italmobiliare	Ciments Français	Concrete	1 537,9	No
8. Kingfisher	Darty	Retailing	1 268,5	Yes: M.0300
9. Tomkins Ranks	Hovis McDougall	Food	1 157,8	No
10. National Power	Electricidade	Energy	1 044,4	No
11. Bacardi	Martini & Rossi	Spirits	1 038,3	No
12. Deutsche Bank	Gerling Konzern	Insurance	979,2	No
13. Cementos Mexicanos	Valenciana Cementos	Cement	924,4	No
14. Allianz	Veba	Distribution	816,9	No
15. Virgin	Thorn	Electronic	785,7	Yes: M.0202
16. Crédit Lyonnais	BFG Bank	Banking	721,3	Yes: M.0296
17. Hachette	Matra	Telecommunications	719,1	No
18. Ti Group	Dowty Group	Holding	666,0	No
19. BCE	Mercury	Telecommunications	593,6	No

1991

Acquirer	Target	Industry	Value (million ECU)	Notified
1. Cassa di Risparmio	Banco di Roma (55%)	Banking	2 812,9	No
2. ING	GDS Leasinter (93%)	Financial non-banking	2 373,3	No
3. Iberduero	Hidroelectrica	Electricity	2 297,1	No
4. BTR	Hawker Siddeley Group	Holding	2 028,5	No
5. Catalana de Gas	Gas Madrid	Gas	1 553,4	No
6. Lasmo	Ultramar	Oil and gas	1 462,9	No
7. Bancario San Paolo	Crediop (50%)	Financial non-banking	1 370,7	No
8. Elf/Enterprise	Occidental	Oil and gas	1 148	Yes: M.0085
9. Cassa di Risparmio	Banco di Santo Spirito (49%)	Banking	1 102,9	No, minority stake
10. ABP	Rodamco (12,5%)	Insurance	1 091,5	No, minority stake
11. Consortium	Deutsche Interhotel	Hotel trade	1 083,5	No
12. Paribas	Ciments Français (70,3%)	Cement/lime/plaster	948,6	No
13. Gardini/Vernes	Centrale d'investissement	Financial non-banking	918,8	No
14. Redland	Steetley	Clay products	856,6	No
15. Crédit Lyonnais	Usinor-Sacilor (20%)	Iron/steel	744,6	No, minority stake
16. Pinault	Au Printemps (66%)	Distribution	734,3	No
17. Metallgesellschaft	Feldmuehle Nobel	Mechanical engineering	708,4	No
18. Cragnotti & Partners	Ja/Mont (50%)	Financial non-banking	675,3	No
19. Pinault	Conforama	Business services	637,3	No
20. Paribas	Poliet (62,5%)	Financial non-banking	635,9	No
21. Saint Louis Bouchon	Arjomari prioux (58,58%)	Business services	618,3	No
22. Williams	Yale and Valor	Business services	578.7	No
23. Hanson	Beazer	Clay products	574,6	No
24. Inchcape	Tozer Kemsley & Millbourn	Business services	534,7	No
25. Ifint	Exor	Real estate	530,3	Yes: M.0187
26. Accor	Wagons-Lits	Business services	521,0	Yes: M.0126
27. Whirlpool Corporation	Whirlpool International	Electrical appliances	516,5	No
28. Cir	Arnoldo Monadadore Editore	Business services	516,1	No

Source: Amdata.

Table 18

Total number of mergers from 1991 to March 1993 falling within the scope of different thresholds[1]

(million ECU)

Aggregate turnover	Individual turnover > 250	Individual turnover > 175	Individual turnover > 100	Individual turnover > 75	Individual turnover > 0
		Part A: Cross-border and non-cross-border			
> 5 000	86	108	152	184	635
> 4 000	95	118	171	205	694
> 3 000	109	136	199	237	792
> 2 000	122	157	232	281	952
> 1 000	141	187	287	353	1 243
		Part B: Cross-border			
> 5 000	32	47	75	92	341
> 4 000	34	49	85	102	375
> 3 000	38	55	99	119	441
> 2 000	46	66	117	147	532
> 1 000	57	85	148	187	694

[1] All M&A deals where at least one Community firm was involved and full control was attained.

Source: Amdata.

2.3. Conclusion

Mergers and acquisitions have shown important activity during the period considered (1986-92). A peak occurred in 1990 in Europe which has been explained as an effect of the single market programme. Activity was more volatile at international and Community levels than at national levels.

Increasingly, concentrations have been motivated more by a search for expansion and strengthening of market position rather than rationalization and diversification. These latter objectives already seem to have been realized in 1985 and 1986, after which period enterprises' concerns were more related to extending their markets.

As far as concentrations are concerned, attention is turned more and more to European enterprises. The reason is likely to be found in the desire of enterprises outside the Community to enter the single market, and in the need to reach a critical size for enterprises inside the Community.

Germany's unification has been one of the major events of the last decade and privatization of State-owned companies there has contributed significantly to maintaining the number of M&As after 1990. Germany, in particular, and its neighbouring countries revealed the most interest in the opportunities available.

With completion of the single market, it is the services sectors especially that show the largest increase in activity. In industrial sectors, concentration started earlier as many trade barriers had already been abolished.

The large number of mergers and acquisitions has contributed to increasing links between Member States' economies, leading to the conclusion that enterprises increasingly consider the Community as a single market.

Chapter 3

The implementation of the Merger Regulation: an overview

3.1. Transactions notified under the Regulation

The Merger Regulation came into force on 21 September 1990. Between that date and the end of June 1993, 164 operations were notified to the Commission. Of these, 17 were found not to fall within the scope of the Regulation. By contrast, Amdata records more than 16 000 acquisitions of majority or minority stakes involving EC companies in the years 1990 to 1992, of which 1 430 were of a significant size (valued at more than ECU 25 million). The Commission's DOME database, which covers only the largest firms, records 1 880 transactions, including joint ventures, for the two-year period from June 1990 to May 1992.[1]

The Amdata and DOME records mentioned above cover only operations in which EC companies were involved as either bidders or targets; they do not include transactions between companies based outside the Community. In all probability, therefore, the figures quoted above for comparison do not fully reflect the number of operations which may have an effect on Community markets. This is because the increasing globalization of the economy means that deals taking place outside the Community can have an impact on it even when no Community-based firm is involved. Nevertheless, it is clear that, because of the very high turnover thresholds laid down in Article 1 of the Regulation, a large number of transactions potentially of interest to the Community are excluded from the scope of the Regulation.

3.2. Types of operation notified under the Regulation

Table 19 gives a breakdown of the notifications received up to 29 June 1993 according to the type of operation concerned. The largest number of notifications (77) related to the creation of joint ventures, followed by majority acquisitions with 76 notifications.

Majority acquisitions and true mergers together make up 50% of the total number of notifications and are thus slightly under-represented by comparison with the DOME data, where they represent 59% of all operations. Only two acquisitions of minority shareholdings were notified, although such operations account for 25% of the operations in the DOME database. This last observation is unsurprising, however, since minority acquisitions are covered by the Regulation only if they lead to a change of control.

The high proportion of joint ventures (47%) is remarkable. As noted in Chapter 2, there is a certain preference among large firms for this type of arrangement. One would therefore expect to find a fairly large number of joint ventures amongst the notifications received under the Regulation. Nevertheless, in the DOME database, whose coverage is limited to the largest firms, only 311 joint ventures are recorded for the period June 1990 to May 1992, a mere 17% of the total number of deals. This disparity may be explained partly by the fact that database managers do not always have sufficient information to distinguish accurately between joint ventures and other types of operation. Furthermore, joint ventures involving several relatively small firms can qualify for Community control because aggregate turnover, rather than individual turnover, is the decisive factor. Nevertheless, the fact that almost half of the notifications were related to such transactions exceeds all expectations.

It is possible that some operations which might otherwise have taken the form of partial acquisitions, i.e. the outright purchase of a self-contained part of another enterprise, may have been cast in the form of joint ventures specifically in order to qualify for Community control under the Merger Regulation. A joint venture is more likely to fall within the scope of the Regulation because the total turnover of all the parties is taken into account. In the case of a partial acquisition, only part of the seller's turnover is taken into account. From the point of view of the participating enterprises, Community control has the advantages of providing a 'one-stop shop', rapid treatment of cases and the assurance that a non-nationalistic approach will be adopted.

It has also been suggested that the number of joint ventures notified under the Regulation has been inflated by the wish of some enterprises to avoid control under Article 85 of the EC Treaty.[2] The Merger Regulation does not apply to joint ventures which lead to the coordination of competitive behaviour between the parent companies or between them and the joint venture (Article 3.2 of the Regulation). Such cases, known as cooperative as opposed to concentrative joint ventures, are subject to control under Article 85 EC.

[1] See European Commission, *Twenty-second Report on Competition Policy*, 1992. The DOME database covers operations involving the 1 000 largest industrial firms in the Community, the 500 largest industrial firms in the world and the largest firms in the banking, insurance and distribution sectors.

[2] See for example Neven, Nuttall and Seabright (1993), Chapter 3.

The importance of the definition of concentrative joint ventures is illustrated by the fact that it is the most common basis for deciding that a notification falls outside the scope of the Regulation.

From the point of view of the parties, the main disadvantages of control under Article 85 EC are that the procedure for obtaining clearance may be slow and that the clearance decision, once taken, is not valid indefinitely but usually for a period of between five and 15 years. It is therefore conceivable that the adoption of the Merger Regulation has led to an increased preference for concentrative rather than cooperative forms of joint venture. However, as the DOME database includes both types of joint venture, this hypothesis does not explain why joint ventures figure so much more prominently amongst notified cases than amongst inter-firm transactions in general.

Table 19

Notifications by type of operation concerned (21 September 1990 to 29 June 1993)

Type of operation	Number of notifications	Percentage of total
Majority acquisition	76	46
Joint venture	77	47
Merger	6	4
Minority acquisition	2	1
Demerger	1	1
Cross shareholding	2	1
Total	164	100

Source: MTF, DG IV.

3.3. Geographical aspects

Nationality of the enterprises

Table 20 summarizes the notifications received according to the nationalities of the firms concerned. As one would expect, the largest Member States are the most heavily represented. France tops the list with 62 notifications, followed by the United Kingdom with 50 and Germany with 44. In the ranking of the Member States the influence of the Regulation's thresholds can again be seen when we make a comparison with the breakdown of deals involving Community-based firms (as either bidder or target) as recorded by Amdata in the period 1990-92. In the period under consideration there was a much larger number of deals involving UK and German firms than French firms but the average size of the French deals was greater, so that more of them fell within the scope of the Regulation. Similarly, although there were almost as many transactions involving Dutch firms as Italian firms in the period 1990-92, and many more than the number of deals in which Spanish firms were concerned, the Netherlands rank below Spain and far below Italy in respect of their share in the total number of notifications.

The USA with 29 notifications ranks well above most Community countries. Firms based in the EFTA countries (mainly Sweden and Switzerland) were also involved in 29 notifications. Japanese firms, on the other hand, were parties to only six notifications, reflecting their preference for 'green field' investment.

Table 20

Notifications (21 September 1990 to 29 June 1993) and breakdown of Amdata records (1990-92) by nationality of firms involved

Firms based in	Number of notifications (in brackets: percentages of the total number of notifications)	Deals recorded by Amdata (percentages of the total number of deals recorded)
Belgium	7 (4)	2
Denmark	3 (2)	5
Germany	44 (27)	25
Spain	15 (9)	3
France	62 (38)	19
Italy	22 (13)	7
Luxembourg	1 (1)	0
Netherlands	14 (9)	7
Portugal	3 (2)	0
UK	50 (30)	29
USA	29 (18)	—
EFTA countries	29 (18)	—
Japan	6 (4)	—

Source: MTF, DG IV.

Table 21 classifies the notified transactions according to the cross-border links established by them. It shows that a very high proportion (71%) of the notifications concerned cross-border deals involving Community firms, while only 18% of the cases related to firms based in the same Member State. In addition, more than 10% of the cases were transactions which did not involve any Community company.

The large percentage of cross-border cases is primarily a consequence of the thresholds laid down in the Regulation and does not reflect the overall pattern of merger activity. Although cross-border deals have increased considerably in relative importance since the mid-1980s, the number of purely national transactions still exceeds that of cross-border deals. According to Amdata, purely national transactions accounted for 56% of the total number involving Community companies in the period 1990-92. However, if we restrict the sample to the largest firms, as in the DOME database, we find that a significantly smaller proportion of the deals are purely national (47% in the period June 1990 to May 1992).

The most common cross-border transactions notified were between French and German firms (16 cases), followed by France/UK (12 cases), UK/USA (9 cases) and France/Italy (8 cases). In contrast, by far the commonest pair of nationalities found in the Amdata records for 1990-92 is UK/USA with 496 deals, while the second most frequent pair is Germany/USA with 296 deals. French/German transactions take third place in the Amdata records (282 deals).

Of the 30 notifications of transactions between companies based in the same Member State, 9 occurred in Germany, 8 in France and 7 in the UK (see Table 22). Amdata, on the other hand, shows that many more national deals occurred during the period 1990-92 in the UK and Germany (3 190 and 2 897 respectively) than in France (1 884).

Relevant geographical markets

After the Commission has decided that a notified transaction falls within the scope of the Regulation, the next step, before any judgment can be made about its possible effects on competitive conditions, is to determine the relevant market

Table 21

Cross-border and non-cross-border operations (21 September 1990 to 29 June 1993)

Notifications involving	Number of notifications	Percentage of total
Firms of different Member States	65	40
EC and non-EC firms	51	31
EC firms of same nationality	30	18
Extra-EC firms only	18	11
Total	164	100

Source: MTF, DG IV.

Table 22

Operations by nationality of the companies involved (notifications received between 21 September 1990 and 29 June 1993)

	B	DK	D	E	F	I	L	NL	P	UK	USA	EFTA	Japan	Others
B	1	0	0	1	2	0	0	1	0	1	0	0	0	0
DK		0	1	0	0	0	0	1	0	2	0	1	0	0
D			9	1	16	1	0	4	0	7	4	7	1	3
E				0	4	3	0	0	1	3	1	0	0	3
F					8	8	1	3	0	12	7	5	2	6
I						4	1	1	0	3	1	1	0	3
L							0	0	0	0	0	0	0	0
NL								1	2	3	1	2	0	2
P									0	0	0	0	0	0
UK										7	9	8	0	2
USA											5	2	2	2
EFTA												7	0	3
Japan													2	0
Others														1

NB: The entries in this table correspond to pairs of nationalities involved in notified deals. As some notifications relate to companies of more than two nationalities, the total number of entries is greater than the number of notifications. Where cross-border transactions involve more than one company of the same nationality, only the cross-border pairs are counted (i.e. there is no entry on the diagonal).

Source: MTF, DG IV.

in terms of both the products and the geographical market (or markets) concerned. This often proves to be an extremely difficult task, particularly since increasing economic integration means that geographic markets are not necessarily stable. In a few cases, however, it becomes clear in the course of the Commission's investigations that a precise definition of the relevant market is not essential because, even with a narrow market definition, the post-merger entity's market share would not be so large as to give rise to any fear that a dominant position could be created.

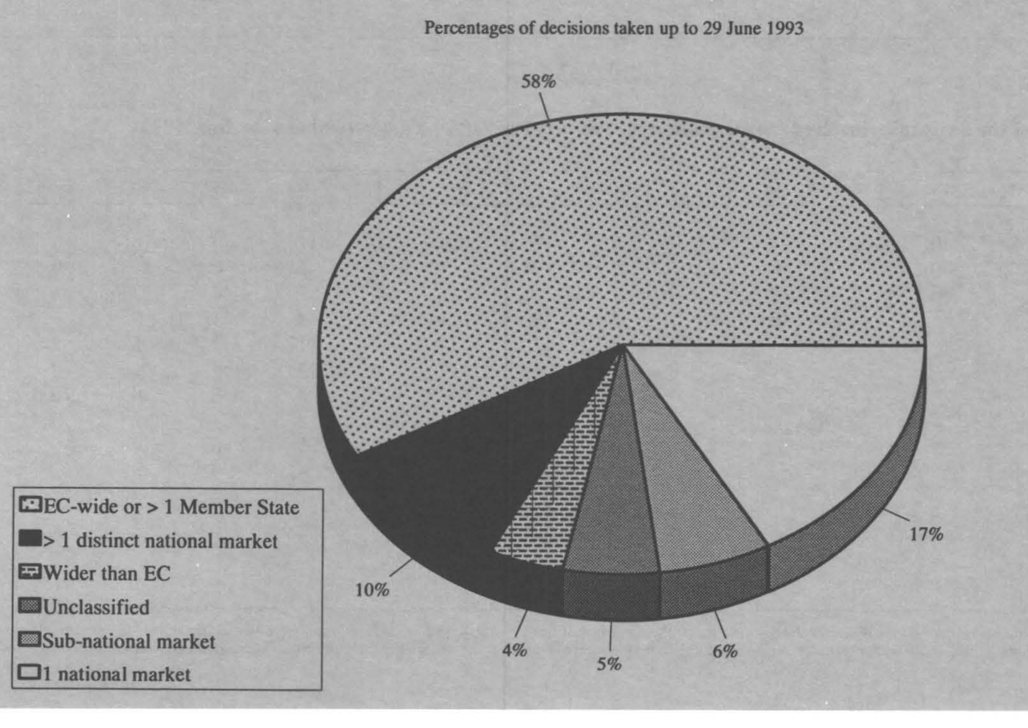
In more than 70% of the decisions taken up to the end of June 1993 on cases falling within the scope of the Regulation, either the relevant geographic market is deemed to extend over more than one Member State or more than one distinct national market is affected. In a small number of cases (4% of the total), the relevant market was wider than the Community. In 23% of the cases, only one national or sub-national market was identified (see Graph 11).

As we have already seen, only 18% of notified cases concerned deals between companies in the same Member State. Those cases do not always overlap with cases where the relevant geographic market was defined as national or sub-national. It is therefore clear that the overwhelming majority of deals subject to the Regulation have an obvious Community dimension, either because they are cross-border transactions or because they affect markets which are not restricted to one Member State.

Furthermore, the Commission received only five requests under Article 9 of the Regulation from Member States for cases to be referred to their antitrust authorities. This Article allows any Member State to request referral if a concentration threatens to create or strengthen a dominant position in a distinct national or sub-national market. The Commission agreed to only one of these requests, in the Steetley/Tarmac case. In this case, the United Kingdom authorities considered that the proposed joint venture could be harmful to competition in local markets for bricks in parts of England and in the British market for clay tiles. The Commission agreed to refer to the UK authorities the aspects of the deal which related to these two products. The other four requests for referral all came from the German authorities and related to the following cases: Varta/Bosch, Alcatel/AEG Kabel, Mannesmann/Hoesch and Siemens/Philips.[1]

[1] See European Commission, Twenty-first and Twenty-second Competition Policy Reports.

GRAPH 11: Relevant geographic markets



3.4. Sectoral distribution of cases

The majority of cases (108) notified to the Commission were concerned with industrial activities, while there were 77 notifications relating to service sectors. Included in these figures are 21 cases which involved both industrial and service activities. The distribution between industry and services therefore seems to reflect quite well the relative levels of merger activity in these two branches of the Community economy. In the KPMG database, services sectors account for 41% of the total number of operations in the Community in the years 1990-92. For the period June 1990 to May 1992, the DOME database classifies 31% of recorded operations in the banking, insurance and distribution sectors but does not include other service activities. The figures provided by Amdata, on the other hand, which include many more small deals, suggest that the services sectors accounted for the majority (53%) of deals in the Community between 1990 and 1992.

Table 23 gives a more detailed breakdown of the notified cases, showing the sectors most frequently concerned and other sectors where merger activity has been intense in recent years. As one would expect, the industrial sectors which are most strongly represented tend to be those where large multinationals play a significant role, such as the chemical industry, electrical and electronic products and motor vehicles. It is also noteworthy that several of the most frequently occurring sectors have characteristics which suggest a special risk of anti-competitive behaviour. For example, there are already high levels of concentration in the electrical and electronic sectors (including computers), in the motor vehicle and other transport equipment sectors and in parts of the food industry.

The last two columns of Table 23 show the number of transactions in each sector recorded in the Amdata and DOME databases. We have selected from Amdata only the 1 430 records relating to deals with a value of more than ECU 25 million, as smaller deals are less likely to have a strong economic impact. Although the periods covered are not exactly the same, it is obvious from this comparison that in all sectors the number of cases dealt with by the Commission represents only a small proportion of the total number of deals carried out. As noted in Chapter 2, the three databases differ widely in their coverage. For our present purposes perhaps the best basis for comparison, where data are available, is the DOME base, which covers only the largest companies and therefore probably gives a better indication of the number of deals which are likely to have a cross-border impact.

No cases were notified in the non-metallic minerals, textile, footwear and clothing sectors, although merger activity has been quite intense.

The number of notifications was particularly small in comparison with the number of deals registered in DOME in the following sectors: pulp and paper, primary metals sector (production and preliminary processing of metals) and construction/civil engineering.

As far as services are concerned, the very small proportion of deals in the banking and business services sectors which were covered by the Regulation are particularly striking. In the banking sector especially, the deals carried out in the years 1990-92 were on average very large: KPMG gives a mean value of ECU 28 million, while Amdata gives a mean of at least ECU 38 million.[1] It is therefore quite probable that in this sector some deals of considerable potential significance to the Community were not subject to the Regulation because of the high level of the thresholds or because of the special definition of banking turnover.

3.5. The Commission's decisions

In 17 of the 164 cases notified up to the end of June 1993, the Commission took decisions under Article 6(1)(a) of the Regulation, declaring that the Regulation was not applicable, either because the turnover criteria were not satisfied or — most commonly — because the case concerned a cooperative joint venture (see Section 3.2 above). Thus, in two years and nine months of operation of the Regulation 147 cases fell within its scope, an average of only 53 cases per year. Table 24 summarizes the initial treatment of the cases.

In nearly 90% of the cases falling under the Regulation, the Commission considered that the concentration did not raise serious doubts as to its compatibility with the common market, i.e. that the operation was not likely to create or strengthen a dominant position which would significantly impair effective competition. It therefore took a decision under Article 6(1)(b) of the Regulation clearing the deal in the first phase of the investigation. However, in seven of these 129 cases, the Commission took an Article 6(1)(b) decision only after the parties (or in some cases a third party) had given a commitment to take measures to resolve the competition problems arising from the deal (see Box 2).

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1 No value is entered in the Amdata base for transactions below a certain minimum value. Hence, it is not possible to calculate an exact average. The mean value of the 128 deals valued at more than ECU 25 million was ECU 258 million.

Table 23

Sectoral breakdown of cases notified between 21 September 1990 and 29 June 1993 and comparison with the number of deals recorded by Amdata and DOME

Sector	Number of cases	Amdata (1990-92) value > ECU 25 million	DOME (June 1990 to May 1992)
Total industry	108[1]	779	1 295
Transport equipment	19	38	86
of which:			
• motor vehicles	12	22	:
• other transport equipment	7	16	:
Chemicals[2]	18	101	235
Electrical of which:	16	83	171
• electrical engineering	12	74	156
• office and EDP equipment	4	9	15
Food and drinks	15	126	184
Pulp and paper	6	69	135
Mechanical engineering	6	61	70
Primary metals	5	30	150
Extractive industries of which:	4	49	41
• coal, oil and gas	3	29	:
• metal ores	1	7	:
• non-metallic minerals	0	13	—
Construction	3	28	142
Textiles and clothing	0	34	42
Total services	77	651	585
Distribution of which:	17	149	112
• wholesale	8	77	:
• retail	9	72	:
Business services	12	116	:
Insurance	10	54	143
Banking	8	128	330

[1] Some notifications concern more than one sector. The sum of industry and services is therefore greater than the total number of notifications (164).
[2] Including man-made fibres.
Source: MTF, DG IV.

In 11 instances the Commission concluded after conducting its initial examination that there was a prima facie case for believing that the deal could have a detrimental effect on competition. It therefore opened the second, more detailed phase of the investigation. The results of this second phase are summarized in Table 25.

Only one merger was prohibited by the Commission. This was the Aérospatiale-Alenia (ATR)/de Havilland merger. In this case, the Commission considered that the deal would lead to the creation of a dominant position in the worldwide market for medium-sized (40 to 59 seats) regional turboprop airliners and strengthen ATR's already dominant position in the market for larger (more than 60 seats) airliners, significantly endangering competition in these markets.

Although this was the only prohibition decided by the Commission, in the majority of the other cases which entered Phase 2 the Commission's approval was conditional on the fulfilment of undertakings given by the parties with a view to reducing or eliminating the dangers to free competition (see Box 2).

Table 24

Notifications and their initial treatment

Notifications received up to 29 June 1993	164
Cases not within scope of Regulation (Article 6(1)(a) decisions)	17
Cases deemed not to raise serious doubts (Article 6(1)(b) decisions)	129
Phase 2 proceedings initiated (Article 6(1)(c) decisions)	11
Notifications withdrawn before completion of Phase 1	2
Phase 1 not completed by 29 June 1993	5

Source: MTF, DG IV.

Table 25

Results of Phase 2 proceedings up to 29 June 1993

Notification withdrawn during Phase 2	1
Number of final decisions	10
of which:	
• Approval without commitments (Article 8(2), paragraph 1)	2
• Approval with commitments (Article 8(2), paragraph 2)	7
• Prohibition decision (Article 8(3))	1

Source: MTF, DG IV.

Box 2: Commitments

In some cases it is possible to remedy important competition problems posed by the transaction either by modifying the terms of the deal or by requiring the fulfilment of supplementary conditions. The Commission has cleared 14 cases on condition that such commitments be fulfilled. The cases concerned are listed below.

Phase 1 decisions (Article 6(1)(b))

Fiat Geotech/Ford New Holland (1991)
TNT/Canada Post et al. (1991)
Courtaulds/SNIA (1991)
Grand Metropolitan/Cinzano (1992)
Elf Aquitaine-Thyssen/Minol (1992)
Air France/Sabena (1992)
British Airways/TAT (1992)

Phase 2 decisions (Article 8(2), paragraph 2)

Alcatel/Telettra (1991)
Magneti Marelli/CEAc (1991)
Varta/Bosch (1991)
Accor/Wagons-Lits (1992)
Nestlé/Perrier (1992)
Du Pont/ICI (1992)
KNP/Bührmann-Tetterode/ VRG (1993)

The Commission is reluctant to accept as a basis for a clearance decision commitments whose fulfilment cannot be easily verified. It therefore favours the so-called structural type of commitment, which involves a single, easily identifiable act, the effects of which cannot be readily reversed. Such structural commitments include the renunciation of contracts, the sale of physical assets or shareholdings or withdrawal from certain activities.

The cases where the renunciation of contracts was required were Fiat/Ford, Grand Metropolitan/Cinzano, Varta/Bosch and KNP/Bührmann-Tetterode/VRG. In the first of these cases, Fiat agreed to terminate an agreement with an Italian farmers' organization under which Fiat was the sole supplier of certain types of agricultural machinery. In the second case, Grand Metropolitan had to renounce its position as sole distributor in Greece of the products of Martini, Cinzano's main competitor, while in the Varta/Bosch case, Varta was required to renounce a licence agreement with a competitor in the battery market (Deta-Mareg). In the KNP case, the merged entity would have been the principal distributor in Belgium and the Netherlands of the products of the two main European printing press manufacturers. The Commission's clearance decision was therefore conditional on the parties' renunciation of their agreement with one of these two suppliers.

Sales of shareholdings or physical assets were required in seven cases: Courtaulds/SNIA, Alcatel/Telettra, Magneti Marelli/CEAc, Accor/Wagons-Lits, Nestlé/Perrier, Du Pont/ICI and the KNP case mentioned above. In the first of these cases, the problem of a very high degree of concentration in the West European acetate yarn market was exacerbated by the fact that Courtaulds had a minority shareholding in one of the three competitors of the merged entity. The Commission therefore cleared the deal only after Courtaulds agreed to dispose of this shareholding. In the Nestlé/Perrier case, Nestlé had to sell some of its mineral water springs and trade marks to a third party other than BSN, the other major company in the French mineral water market. In addition, Nestlé was not allowed to sell its Volvic business to BSN until the first commitment had been fulfilled.

In the two airline cases mentioned above, Air France/Sabena and British Airways/TAT, the parties were required to cede certain routes or scheduled services to other operators. The fulfilment of these commitments, being largely dependent on the interest of third parties in taking over the services concerned, is less easy to monitor than the other commitments mentioned above.

When the Commission is able to monitor the fulfilment of an obligation or when competitors are likely to report any infraction, the Commission may be willing to accept non-structural or behavioural commitments. In the Varta/Bosch case the Commission's clearance decision was based partly on such a behavioural commitment. In addition to the structural commitment to renounce a licence agreement with Deta-Mareg, Varta also agreed to sever its personal link with that firm through representation on its board of directors.

In two other cases, the Commission's approval was subject to purely behavioural obligations. These were the TNT/Canada Post and Elf Aquitaine/Minol cases. The first of these concerned a joint venture between the Australian firm TNT and five national postal administrations in the field of international express delivery services. There was a danger that this would lead to the creation of a dominant position since the parties intended to grant the joint venture exclusive access to many of their postal outlets for a period of five years. Furthermore, the joint venture was to have the right to sub-contract certain services to the postal administrations, with a consequent danger of cross-subsidization. However, the Commission approved the deal after the parties agreed to limit the duration of the exclusive access arrangement to two years and to reduce the number of outlets covered by the arrangement. In addition, the postal authorities agreed to act as sub-contractors for other clients on terms similar to those offered to the joint venture.

The Elf/Minol case concerned the purchase by a joint venture led by Elf Aquitaine of most of the assets of the State-owned East German petrol distribution company Minol. The joint venture was also to manage two oil refineries on behalf of the Treuhandanstalt, the State body responsible for privatization. As there was a danger that Elf would thereby obtain a large share of the market for motor fuels in Eastern Germany, the Commission approved the transaction only after the parties agreed that competitors would be allowed to supply the joint venture's petrol stations on normal commercial conditions. In addition, the Treuhandanstalt agreed to appoint an independent expert to ensure that the prices charged by the refineries were normal market prices and that Elf did not gain any unfair advantage from the management arrangement.

3.6. Conclusions

From the comparisons made in Sections 3.1 and 3.4 above it is clear that the Merger Regulation affects only a very small proportion of the total number of inter-firm transactions, mainly because of the high level of the turnover thresholds laid down in Article 1. Furthermore, this conclusion is valid for all sectors, even those where very large firms are active and the degree of concentration is high. It is unsurprising, therefore, that the vast majority of the cases covered by the Regulation have an immediately obvious Community dimension, as shown in Section 3.3, either because they concern cross-border transactions or because the geographic market is not limited to one Member State. The Regulation therefore certainly does not offend against the principle of subsidiarity. Unfortunately, however, the narrow definition of the Regulation's scope probably results in the exclusion of many deals which may have a significant impact on the Community. In this respect, the very poor coverage of operations in the banking sector is particularly noteworthy.

The Commission's treatment of cases under the Regulation has sometimes been criticized as lax. The fact that only one deal has been prohibited is usually cited in support of this criticism. However, this criticism is not borne out by a comparison with the experience of the German antitrust authority (the Bundeskartellamt), which is often cited as a model of strict enforcement of competition rules. Since 1973, the Bundeskartellamt has examined more than 13 000 mergers but fewer than 1% of these mergers were forbidden. In any case, the discussion of this question cannot validly be conducted on the basis of statistics but requires a careful analysis of each operation. Furthermore, it is important not to overlook the fact that in 14 cases the transaction was cleared by the Commission only after the parties had agreed to — often very stringent — conditions.

Chapter 4

Key questions of Community merger control and their economic background

Merger control at Community level is neither a synthesis nor the smallest common denominator of national merger control policies.[1] It has developed out of a distinct tradition of Community competition policy and it addresses specific Community objectives. The differing philosophies and practical experiences of a number of Member States, and to a lesser extent of other industrialized countries, have contributed to this tradition and are influential in its application and further development. The same is true of the different schools of economic competition theory. Expanding on the introduction to the Community Merger Regulation presented in Chapter 1, this chapter discusses in more detail some key questions with reference to the Regulation's historic roots in Community competition policy, national practices and economic thinking. Section 4.1 reviews the objectives shaping Community merger control. Section 4.2 discusses the question of the Community dimension, Section 4.3 the assessment of dominance. This chapter also puts into context the studies by external experts published in Part B.

4.1. The objectives shaping Community merger control

Preserving and developing competition

The Community Merger Regulation has been explicitly created to be part of the 'system ensuring that competition in the common market is not distorted'[2] which the EEC Treaty established from 1957 as a Community objective in Article 3(f).[3] In the preamble of the Regulation, Recital 13 requires that compatibility of concentrations with the common market has to be established 'from the point of view of the need to preserve and develop effective competition in the internal market'. Its Article 2.2 determines that the creation or strengthening of a dominant position 'as a result of which effective competition would be significantly impeded in the common market' is to be the criterion for the appraisal of concentrations. Competition is to be the objective for Community merger control. In the words of the Commissioner in charge of Community competition policy at the time of the adoption of the Merger Regulation, Sir Leon Brittan: 'Competitive structures must be safeguarded and that is the role of merger policy. The Community has today the instrument and the policy to fulfil the promise of undistorted competition made in 1957 by the authors of the Treaty of Rome in Article 3(f)'.[4]

Contributing to the development of the internal market

At the same time the Regulation is put firmly in the context of Community integration and, in particular, the achievement and further development of the internal market (Recitals 2 to 4). In addition, Article 2 mentions that among several factors to be taken into account in the appraisal of concentrations is the 'development of technical and economic progress' providing that it is 'to the consumer's advantage and does not form an obstacle to competition'. The role of technical and economic progress in the context of the Merger Regulation is thus more restrictive than in Community control of cartels. Article 85(3) EC allows for the prohibition of cartels to be declared inapplicable if an agreement or practice 'contributes ... to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not ... afford ... the possibility of eliminating competition in respect of a substantial part of the products in question'. The insistence of the Merger Regulation that development of technical and economic progress cannot be taken into consideration if it forms an obstacle to competition has led to the conclusion that 'the role of the efficiency criteria in the Regulation is empty'.[5] The risk of a potential conflict of objectives has in particular been discussed in the run-up to the adoption of the Regulation,[6] and the controversy was revived by the negative Commission decision in the de Havilland case. The first years of application of the Regulation have, nevertheless, clarified three aspects: the trade-off between efficiency and competition, the integration objective, and the role of an efficient merger control procedure.

1 Dumez, H. and Jeunemaître, A. (1991).
2 Recital 1 of the preamble.
3 See Annex to Part A of this issue.

4 Brittan (1990), p. 31.
5 Jacquemin (1990) , p. 549.
6 The Commission draft Regulation of 1989 explicitly permitted a balancing test allowing authorization where mergers 'contribute to the attainment of the basic objectives of the Treaty in such a way that, on balance, their economic benefits prevail over the danger they cause to competition' (OJ C 22,1989, p. 14).

The trade-off between efficiency and competition

The stock-taking on Community integration in the middle of the 1980s[1] revealed a still considerable degree of segmentation of the common market along national lines. Physical, technical and tax barriers were identified which imposed direct costs on intra-Community trade and production. The internal market programme therefore undertook to remove a large number of non-tariff barriers between the Member States.[2] But equally important[3] was a significant potential for cost reductions due to economies of scale and scope, a better use of comparative advantages and improvements in the internal organization of firms. The latter gains depend on enterprises actively adjusting their strategies to the opportunities of the Community-wide market. An increase in price competition is the key driving force for these adjustments.

The results of a June 1989 survey among European industrialists concerning the impact of '1992'[4] and the wave of cross-border mergers and acquisitions in the second half of the 1980s (see Chapter 2) indicate that the strategies of many enterprises in the Community have, indeed, aimed at achieving an optimal size within the internal market. External growth through acquisitions has been the preferred approach since it provides a fast access to new regional markets and possibly to efficiency gains. As mergers reduce the number of independent actors and may also increase market power, a trade-off appeared to emerge between the efficiency potential of the internal market and merger control.

The theoretical possibility that efficiency enhancing mergers may be welfare-improving even if they create market power has been illustrated, for example, by Williamson (1968): in a static partial equilibrium model he showed that the welfare benefits even of a rather small gain in cost reductions would outweigh the costs of a considerable increase in market power. But if competitors are taken into account who may also increase their prices without any gains in efficiency the relationship is already turned around. Subsequent discussion has provided further qualifications, in particular with regard to the openness to international trade and the technology content of the activities concerned. The highest probability of efficiency gains outweighing an increase in market power may be found in high-technology industries with rapidly expanding demand and a high degree of openness of the Community market.[5] In a stagnating market with high barriers to entry, however, synergies between the concentrating enterprises would even strengthen their competitive position *vis-à-vis* remaining and potential competitors.

In practice efficiency gains from mergers are difficult to realize. While companies often expect to obtain cost reductions through mergers, *ex post* evaluations do not support a general presumption that these gains are actually achieved.[6] More often than not then, the supposed conflict of objectives does not arise because efficiency gains will be difficult to obtain. If this is not the case in a specific situation, the burden of proof is on the merging enterprises. The difficulties of such a proof may be one reason why, in the practice of Community merger control, there has not yet been a single case where enterprises have explicitly attempted an efficiency defence backed up by details of considerable[7] expected cost reductions.[8]

Another possibility is that the gains and costs from efficiencies and market power may be unevenly distributed geographically. In the de Havilland case Community enterprises were found to create a dominant position in a global market. Would this not be in the Community's economic interest given that the gain in the form of higher profits would remain in the Community whereas the costs due to higher prices would to a large extent fall on non-Community consumers? In general, Jacquemin (1990, p. 545) observes that 'all things being equal, the European gain in welfare resulting from a merger would be the greater, the larger the degree of European involvement in the merger and the lower proportion of the output consumed in Europe'. Such considerations would explain what Bianchi (1992, p. 15) stipulates as a general law: in a period where a market is closed, there is a tendency to internally strengthen the controls against

1 *European Economy* No 35 (1988).

2 'White Paper on the completion of the internal market', European Commission (1985).

3 The potential static gains from the removal of all barriers to trade and production were estimated to yield an increase in real Community GDP in the region of 2,4%. But when the effects of economies of scale from restructuring and increased production are accounted for as well as the competitive effects on X-inefficiency and monopoly rents, the potential gains amount to some 4,5% of GDP (*European Economy* No 35, (1988), p. 159). Dynamic effects stemming from a higher return to capital could add considerably to the benefits of further integration (Baldwin, 1992).

4 *European Economy and Social Europe* (1990), pp. 54-62.

5 For a classification of 120 European manufacturing industries at the 3-digit NACE level according to the expected effects of a merger on competition and efficiency, see *European Economy* (1989), pp. 24-32 and annexes.

6 For a review of empirical studies on the efficiency effects of mergers see *European Economy* (1989), pp. 21-22, Jacquemin (1990), pp. 541-542 and Neumann (1990), pp. 565.

7 In the de Havilland case the parties submitted expected cost reductions of about 0,5% of the turnover of the combined enterprises.

8 At least not within the procedure. It is, however, quite plausible that such arguments are used in behind-the-scenes and public lobbying. This is why Neven, Nutall and Seabright (1993, p. 240) suggest that efficiency aspects should be explicitly verified by an efficiency audit unit independent from the Commission's Merger Task Force.

monopolies, whereas in a period of market opening the tendency is towards a strengthening of internal concentration to create national champions to defend national interests in supra-national contexts.

Such considerations are based on static effects only. A complete economic evaluation would have to take dynamic implications into account. One dynamic effect is the risk of international retaliation which could lead to a mutual bidding-down of national merger control standards. In the absence of a global merger control authority, international cooperation combined with a visible commitment to a strict enforcement of competition standards at home is a second-best solution.[1] Second, from a purely domestic point of view, questions remain with regard to the potential loss of dynamism and internal efficiency of a European champion.[2] There are a considerable number of examples of globally successful Japanese or American enterprises which have to face fierce competition from domestic competitors. Quite different is the case of a global market already dominated by a tight oligopoly of non-Community firms. From a competition point of view, there is no reason why the consolidation of Community enterprises into a European champion should be prevented by Community merger control. The key question in such cases is the truly global nature of the market.

The integration objective

Another aspect of this debate focuses on the effects of mergers due to the reduction in the number of independent actors. The effective integration in the internal market may be prevented by national champions which attempt to foreclose their national markets to improve their competitive position in a potential or actual Community-wide market.[3] This puts at risk the wider efficiency effects of the internal market. The implications for merger control are two-fold. On the one hand, even purely national mergers may create Community-wide spillovers, and thus become of Community concern (see Section 4.2). On the other hand, the availability of a number of independent actors at a national level capable of constituting European companies becomes a separate aspect in the evaluation of the potential impact of a merger, at least in sectors with high barriers to entry. To give a stylized example: if a market covers two Member States and in each Member State two enterprises share total domestic production, then a purely national merger could *ceteris paribus* be seen as precluding the future possibility of a Community-wide merger. Examples for such considerations entering Community merger control can be found: 'DG IV has endeavoured, in implementing the Regulation, to serve the interests of the creation of the single market, i.e. the opening-up and interpenetration of markets. This is well illustrated in the terms and conditions attached to the Fiat Geotech/Ford New Holland, Alcatel/Telettra, Magneti Marelli/CEAc and Varta/Bosch decisions' (Ehlermann (1992), p. 269).[4]

The role of an efficient merger control procedure

Another way in which Community merger control may actually stimulate the internal market is by the efficiency of its procedure. This is particularly relevant for cross-border operations which are faced with higher legal risks and transaction costs due to the possibility of parallel procedures from different national authorities. The very creation of a Community-wide merger control can thus be seen as the elimination of a technical barrier to integration. The one-stop shop principle of the Merger Regulation, according to which concentrations of Community dimension are assessed in a single procedure, usually at Community level, is often considered the most valuable element of Community merger control, particularly by industry. Efficient merger control can considerably reduce uncertainty and transaction costs and thus facilitate cross-border mergers.

4.2. The scope of the Merger Regulation

The Community dimension

A key element of the Merger Regulation is that its scope of application is quite clearly defined. Three thresholds all have to be crossed by the enterprises involved for a concentration to be found to have a Community dimension, and thus to fall exclusively under Community control:

(i) World-wide combined turnover must exceed a general threshold of ECU 5 000 million. This limits Community

1 For a discussion of the external effects of mergers and the implications for supra-national merger control policy see Section 4.2.

2 Few roles of government are more important to the upgrading of an economy than ensuring vigorous domestic rivalry ... Firms that do not have to compete at home rarely succeed abroad.' (Porter (1989), p. 662).

3 *European Economy and Social Europe* (1990).

4 Similarly: 'Zu beachten ist allerdings in diesem Zusammenhang, daß Zusammenschlüsse nationaler "Champions"der Entwicklung zu einem gemeinschaftsweiten Markt gerade entgegenwirken können, während auf der anderen Seite grenzüberschreitende Zusammenschlüsse zu einer Öffnung der Märkte beitragen können' (Ehlermann (1991), p. 54). In the case Mannesmann/Hoesch the Commission permitted the merger of the two leading German producers of steel tubes in a market which would in the medium term become Community-wide. But competitors from other Member States had already bought small producers in Germany providing potentially a nucleus of European companies in this sector. Furthermore, in other Member States previous concentration had already led to single national producers.

control to enterprises with considerable economic and financial power. In 1990 just 102 industrial enterprises in the Community (and an additional 11 in the EFTA countries) recorded a turnover above this threshold. Altogether, 235 industrial enterprises in the Community and EFTA have a world-wide turnover above ECU 2 500 million and could thus come under Community control in a concentration of equally sized partners. However, the group of enterprises potentially affected is wider because Community merger control also applies to service sector companies, as well as to companies located outside the Community.

(ii) In addition, Community-wide turnover for each of at least two enterprises must exceed ECU 250 million. This *de minimis* threshold has two functions. First it excludes scrutiny of small transactions which would otherwise have to be covered just because one of the firms involved is by itself large enough to exceed the general threshold. By the same token, however, it could also unduly inhibit Community control in cases where large enterprises systematically buy up small, fringe competitors. Second, the *de minimis* threshold limits the extra-territorial reach of the Regulation. Mergers involving non-Community companies come under the control of the Community on the basis of the same three turnover thresholds which apply to Community companies regardless of the place of registration or the location of their company headquarters, but the *de minimis* threshold restricts the scope of Community control to concentrations of companies which have a significant presence in the Community.

(iii) Finally, Community level control does not apply to merging companies if each of them obtains more than two-thirds of its Community-wide turnover in one and the same Member State. This two-thirds criterion is designed to exclude operations which affect primarily a single Member State.

The straightforward method of calculating the relevant turnover contributes to the clarity of the frontiers of Community responsibility. Article 5(3)(1) gives the basic definition as 'the amounts derived by the undertakings concerned in the preceding financial year from the sale of products and the provision of services falling within the undertakings' normal activities ...'. Normally standard accounts can be used. Companies taken into account in the calculation are the undertakings concerned, as well as the groups of which they may be part. The undertakings concerned in a take-over, for example, are the bidder and the target. In the special case of a concentrative joint venture both parents are considered undertakings concerned. This implies that if the parents meet the Community thresholds, any joint venture they may undertake is subject to Community control. If, however, a company purchases part of another company, only the turnover of the acquiring company and of the assets purchased will be taken into account. Companies thus have a certain margin for forum shopping, i.e. to structure a concentration according to their preferences to be subject either to Community control (by creating a concentrative joint venture) or to national control (by an outright purchase of the desired part of another company). The group comprises those companies which control the undertakings concerned, and those which are controlled by them. Thresholds for banks and other financial institutions are defined in terms of their total assets, and for insurance companies in terms of the income received from insurance premiums.

If a concentration has a Community dimension, the Community's jurisdiction is exclusive. Article 21(2) provides that no 'Member State shall apply its national legislation on competition to any concentration that has a Community dimension'.[1] For mergers with a Community dimension this establishes single regulatory control, the one-stop shop principle. While the straightforward delineation of competence provides valuable legal clarity, it is based on an indicator — turnover — which is biased towards bringing mainly concentrations involving very large conglomerate enterprises under Community control. Two potential errors in the attribution of cases may arise. On the one hand, mergers involving very large enterprises in the Community may in fact only have a national impact. To correct this error Member States may request the referral of a case with a Community dimension on the grounds of it creating or strengthening a dominant position in a distinct market (Article 9).[2] Key requirements for such a request to be granted by the Commission are the existence of a distinct geographic market which is no larger than the Member State, and a threat to competition. On the other hand, mergers of smaller enterprises which do not meet the thresholds may well have Community-wide effects. But no comprehensive mechanism is foreseen to correct this error. The Commission cannot request referral of a case from a Member State which it believes to have significant Community impact. Only a Member State which feels that competition on its own territory may be affected by a concentration may request the Commission to examine

1 Member States may take measures to protect legitimate interests, in particular concerning public security, plurality of the media and prudential rules (Article 21(3)). They would be permitted on these grounds to prevent a merger which has been cleared by the Commission, but not vice versa. This clause has, however, never been invoked during the first three years of application of the Merger Regulation.

2 This possibility for referral has been dubbed German clause as the German government insisted on its inclusion. Four out of five requests under this article have so far been submitted by the German government, one from the United Kingdom.

the case (Article 22(3)).[1] The potential intervention of the Commission is limited to a Member State's decision to refer. The possibilities for fine-tuning the allocation of jurisdiction are thus limited. Moreover, they are biased in so far as Member States may request a case from the Commission, but the Commission cannot request a case from a Member State. One way to overcome this bias would be to set rather lower thresholds limiting Community competence (see below).

If a merger has no Community dimension, it may come under national control. When the Regulation was adopted only Germany, France and the United Kingdom had fully fledged institutions for merger control. Since then other Member States have created their own authorities so that today only Denmark, Greece, Luxembourg and the Netherlands still have no facilities for merger control. During the first years of the Merger Regulation's operation, only a few cases are known to have been examined in parallel by more than one national authority. In the future, however, their number may increase as more and more national authorities are set to work.

The appropriate thresholds for merger control

All merger control authorities require a concentration to have a certain economic significance before a control procedure is launched. Most use an explicit threshold, or sometimes several thresholds, above which the enterprises concerned have to notify their intention to the authorities (see Table 26). In the selection of those operations which are to be examined, a balance has to be struck between the threat to competition and the risk of deterring beneficial external growth by prohibitive transaction costs. Several questions arise.

A first question concerns the economic indicator upon which to base thresholds. The potential costs of a merger are related to the resulting increase in market power and the size of the market. In a simple static partial-equilibrium context for example, the welfare loss attributable to monopolistic resource misallocation is a function of total sales under competitive conditions in the relevant market, the demand elasticity and the price distortion due to the monopolization (Scherer (1990), p. 662). Economic indicators which are to identify those mergers whose potential economic damage exceeds a certain level of sensitivity should ideally be based on these variables. In practice however, indicators related to the affected market are difficult to apply as the relevant market is rarely obvious (see Section 4.3) and can only be established by the examining authority. Therefore, when some administrations apply market share as a selection criterion (Belgium, France, Spain, the United Kingdom), they mainly use it as a secondary, corrective factor to mergers preselected by means of other, more directly applicable thresholds.[2] The turnover and/or assets of the merging parties are easier to establish and they give parties to a concentration a large degree of certainty on whether to notify their operation. But they are only indirectly related to the economically preferable filters to the extent that they provide an indication of the economic importance of the enterprises involved. They inevitably introduce a bias into the procedure: enterprises which operate in large markets and conglomerate enterprises are more likely to be scrutinized than small specialized enterprises. Such a bias may be justified by worries about the conglomerate power of larger enterprises. Sectorally differentiated thresholds would reduce the bias, but raise other questions concerning the number of different thresholds to be chosen and the sectoral classification of conglomerate enterprises. Thresholds based on assets rather than turnover would correspond more closely with the conglomerate power which could emerge from a merger. But turnover thresholds have the advantage over asset thresholds in that they can indicate the impact of a merger on a specific territory. They thus trigger examination of a merger if the companies involved have certain sales in the country, even if the assets are fully held outside the country concerned.

Secondly, the level of the threshold(s) has to be appropriate. It differs quite significantly among industrial countries. In relation to GDP, the general turnover thresholds are lowest in the USA and in the United Kingdom. Greece and France, at the other extreme, require a combined turnover of some 0,1% of national GDP before a concentration may be subject to control. If the degree of vigilance towards mergers can be measured by the level of the thresholds triggering a first involvement of national authorities, it is significantly higher in the USA than in the Community — be it at Member State or at Community level. To some extent this may be due to a different degree of openness to international competition which constrains market power in the Community in many sectors. The differences among Community Member States imply that a concentration could be subject to control in

[1] The so-called Dutch clause because the Netherlands and other Member States which had no merger control authorities of their own sought a procedure to have the impact of smaller mergers on their territory examined by a supra-national authority. It has been invoked only once, by the Belgian Government in the case British Airways/Dan Air.

[2] There is in practice no significant difference between the dismissal of a merger case because it turns out that it does not reach a 20% (Belgium) or 25% (France, the United Kingdom) market share and the approval of a merger on the presumption that a market share below 25% does not create a dominant position as it is foreseen by Recital 15 of the Merger Regulation (see Section 4.3).

Table 26

Notification[1] thresholds for merger control

Country	Threshold(s)	General threshold as % of national GDP
Belgium	Aggregated turnover ~ ECU 25 million (BFR 1 000 million) and 20% market share	0,014
Germany	Aggregated turnover ~ ECU 50 million (DM 500 million), *de minimis* = DM 50 million (DM 4 million, if buyer > DM 1 000 million)	0,016
Greece	Aggregated turnover ~ ECU 75 million	0,117
Spain	Aggregated turnover ~ ECU 150 million (PTA 20 000 million)	0,032
France	Aggregated turnover ~ ECU 1 000 million (FF 7 000 million), *de minimis* = FF 2 000 million (25 % market share)	0,095
Ireland	Two companies, each of them at least ~ ECU 4 million (IRL 5 million) assets or turnover IRL 10 million	0,066
Italy	Aggregated turnover ~ ECU 250 million (LIT 500 billion) or target company LIT 50 billion	0,031
Portugal	Aggregated turnover ~ ECU 25 million (ESC 5 000 million)	0,040
United Kingdom	Assets acquired ~ ECU 40 million (UKL 30 million) (25% market share)	(0,005)
EC	Aggregated global turnover ECU 5 000 million, at least two companies with Community turnover > ECU 250 million, 'two-thirds rule'	0,087
USA	1. Party: turnover or assets ~ ECU 75 million (USD 100 million), 2. Party: USD 10 million	0,002

[1] In France and the United Kingdom notification of mergers exceeding the thresholds is not mandatory.

one Member State, but not in another in spite of higher sales in the latter. There is obviously some room here for a convergence of national requirements.

The distribution of responsibilities between the Community and the national authorities

A specific question for the European Community concerns the appropriate distribution of responsibilities between the national and Community authorities. As a response, the Community has more and more explicitly adopted the principle of subsidiarity. The Treaty on European Union (Maastricht Treaty) specifies in a new Article 3b EC: 'In areas which do not fall within its exclusive competence, the Community shall take action, only if and in so far as the objectives of the proposed actions cannot be sufficiently achieved by the Member States and can, therefore, by reason of the scale or effects of the proposed action be better achieved by the Community'.[1] Article 3b confirms that the Community can only act where explicitly given the power to do so (principle of attribution of powers). It clarifies that in areas which do not fall under the Community's exclusive competence, the Community should only take action when an objective can better be attained at the level of the Community because of the scale or effects of the proposed action (principle of subsidiarity in the strict sense), and recalls that the means to be employed by the Community should be proportional to the objective pursued (principle of proportionality). The subsidiarity principle has a built-in preference for decentralized regulation and puts the burden of proof clearly on those advocating more centralized authority.

[1] There are historical antecedents in existing Community Treaties or in the case-law of the Court of Justice. Article 130r(4) EC, for example, which was added to the EEC Treaty by the Single European Act of 1987 specifies for the environmental field: 'The Community shall take action ... to the extent to which the objectives ... can be attained better at Community level than at the level of the individual Member States'.

In the economic literature the subsidiarity principle has its underpinning in the theory of fiscal federalism.[1] This theory derives a presumption in favour of decentralization from two main factors: the informational advantage inherent in closeness between local government and the citizens, and the larger scope for competition between regulators offering a choice to mobile citizens. It also identifies the conditions under which decentralized regulation would assure efficiency. Among the most important are: costless mobility of citizens among jurisdictions, a large number of jurisdictions, no external effects between jurisdictions and complete information about alternative possibilities. However, the advantage of decentralization is reduced by the fact that mobility in the Community is quite costly — even if these costs may decrease with progressing integration — and that the number of different jurisdictions is limited. But there have to be external effects or spillovers of policies beyond the boundaries of individual jurisdictions to make more central authority potentially advantageous.[2] Their existence is, however, not sufficient. It has to be shown in addition that coordination among jurisdictions would not work. Finally, if transfer of competence to a more central level is found to be more efficient, the subsidiarity principle still imposes the obligation to exploit the possibilities for decentralization in the administration of the centralized policies.

Applied to the question of merger control, it is obvious that there is a considerable risk of externalities. Both the benefits of efficiency gains and the costs of stronger market power may affect consumers outside the controlling Member State. Merger control based only on the national effects would tend to be over-restrictive against mergers with strong economies of scale and overindulgent towards mergers which exert market power in third countries. Furthermore, given the high informational costs to establish the consequences of a merger — taking into account also the requirements of business confidentiality — coordination of policies becomes costly as it would require parallel investigations by different national authorities.

While there is thus a good case for merger control at Community level, it is considerably more difficult to define more precisely its delimitations, i.e. the most adequate level of the thresholds above which a merger is assigned to the Community. It becomes an empirical question to establish the actual extent of spillovers measured, for example, by the price increase which a merger cleared by one Member State may have caused in other Member States. Very approximate indications of these spillovers may be found in the total sales of merging enterprises outside their home country. As shown in Chapter 2, the fragmented empirical evidence available does not permit a strong conclusion, but it does provide some indications that the lower thresholds sought by the EC Commission in the negotiations on the Merger Regulation[3] would have brought a substantial number of mergers with considerable spillover effects under Community control between 1990 and 1993. With progressive integration in the internal market and the resulting growth in intra-Community trade, the potential for spillovers is growing. A review of the thresholds has been undertaken in 1993 as foreseen by the Regulation.[4] The Commission found that on the technical level a lowering of the thresholds would seem judicious. But as most Member States had indicated their opposition to any change in the thresholds at this stage, the Commission only declared its intention to undertake a full review at the end of 1996. In any case the real level of the thresholds fixed in nominal terms will continuously decrease with the nominal growth of the Community economy, aided by the addition of new members through enlargement.

4.3. The assessment of concentrations

4.3.1. The general concept

The European Commission's task is to assess the compatibility with the common market of concentrations which fall within its competence. Article 2 of the Merger Regulation provides that the test to be applied is the creation or strengthening 'of a dominant position as a result of which effective competition would be significantly impeded in the common market or a significant part of it'. Concentrations that fail this test have to be prohibited by the Commission. Article 2 provides a list of factors the Commission has to take into account in the application of the test:

'(a) the need to maintain and develop effective competition within the common market in view of, among other things, the structure of all the markets concerned and the actual or potential competition from undertakings located either within or outwith the Community;

[1] The following draws strongly from Neven, Nutall and Seabright (1993), pp. 176-182.

[2] An additional argument for centralization can be economies of scale to the extent that central administration avoids duplication of administrative structures. The discussion in Section 4.1 on efficiencies and competition can *mutatis mutandis* also be applied to governments.

[3] ECU 2 billion for the general threshold and a corresponding reduction of the *de minimis* threshold, see Council Regulation (EEC) No 4064/89, Article 1.

[4] Communication of the Commission to the Council, 'Review of the application of Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings', COM(93) 385 of 28 July 1993.

(b) the market position of the undertakings concerned and their economic and financial power, the alternatives available to suppliers and users, their access to supplies and markets, any legal and other barrier to entry, supply and demand trends for the relevant goods and services, the interests of intermediate and ultimate consumers, and the development of technical and economic progress provided that it is to the consumers' advantage and does not form an obstacle to competition.'

In addition, Recital 13 of the Regulation links the assessment of concentrations with the achievement of the fundamental objectives referred to in Article 2 of the EC Treaty,[1] including the strengthening of the Community's economic and social cohesion, referred to in Article 130a of the Treaty.

While there is thus no lack of assessment criteria — their number and possible conflicts between them have, in fact, given rise to controversy (see Section 4.1) — the Regulation itself does not establish a methodology for assessing whether a concentration actually creates or strengthens a dominant position. Recital 15 introduces a presumption that there will not be an impediment of effective competition by undertakings with a market share of less than 25%. But there is no presumption of a dominant position based on market shares, as there is in Germany and in the application of US merger control law.[2] The Regulation alone could therefore be seen as leaving a wide margin for the Community to develop its own methodology.

In reality, the Community approach to merger control has developed from a methodology established by the Commission and the Court of Justice in the application of Articles 85 and 86.[3] In its decision on *Continental Can*,[4] the Commission — later upheld by the Court — has defined a dominant position on the basis of the discretionary power of the enterprise concerned to set its prices and make other market decisions without being tightly constrained by competitive pressures:[5]

'3. Undertakings are in a dominant position when they have the power to behave independently, which puts them in a position to act without taking into account their competitors, purchasers or suppliers. That is the position when, because of their share of the market, or of their share of the market combined with the availability of technical knowledge, raw materials or capital, they have the power to determine prices or to control production or distribution for a significant part of the products in question. This power does not necessarily have to derive from an absolute domination permitting the undertakings which hold it to eliminate all will on the part of their economic partners, but it is enough that they be strong enough as a whole to ensure those undertakings an overall independence of behaviour, even if there are differences in intensity in their influence on the different partial markets.'

In its judgment on *United Brands*[6] and all subsequent judgments the Court has defined a dominant position even more concisely as:

'a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers'.

In applying the concept of a dominant position, the Court has insisted that the Commission analyse a firm's market power in two steps: first, it should define the relevant market and then it should assess the firm's dominance therein. For the latter, it attached major importance to the structural features of the relevant market, in particular the impact of market shares and barriers to entry. A methodological framework emerged for the assessment of a dominant position under Article 86 in three stages (Fishwick (1993b), p. 184):

'A: (1) consideration of substitute products currently available and acceptable to consumers, proceeding formally ... to definition of the relevant product market;

(2) consideration of the geographical dimension of the market;

1 '... a harmonious development of economic activities, a continued and balanced expansion, an increase in stability, an accelerated raising of the standard of living and closer relations between the States belonging to it.'

2 A presumption of a dominant position has been introduced in 1973 into the German Gesetz gegen Wettbewerbsbeschränkungen of 1957. It is based on a post-merger market share of one third for a single firm (Article 22.3 GWB). Presumptions for oligopolistic dominance for the purpose of merger control have been added in 1980 by means of Article 23a GWB: a post-merger combined market share of one half for at most the three largest companies or two thirds for at most the five largest. Current US merger control policy is described in the horizontal merger guidelines, jointly issued on 2 April 1992 by the Department of Justice and the Federal Trade Commission. The guidelines use the Herfindahl-Hirschman index (HHI) which is based on the summed squares of the market shares to define the agencies' likely reaction to a merger. With post-merger concentration exceeding a value of 1 800 in the HHI and the merger producing a change in the HHI of more than 100 a merger will be assessed under the rebuttable presumption that market power will be created or enhanced.

3 The historical roots of Community merger control are developed for example by Glais (1992) and Fishwick (1993).

4 [1972] CMLR D11.

5 Korah (1990), p. 56.

6 Case 27/76 [1978] ECR 207.

(3) computation of shares in the market defined by (1) and (2);

B: evaluation of potential competition — supply substitution, with both product and geographical elements;

C: consideration of competition in "downstream" or composite product markets and (occasionally) of longer-term demand substitution.'.

The implementation of the Merger Regulation has basically maintained this framework. Differences are mainly due to the fact that Article 86 involves an *ex post* analysis of past circumstances which can, at least potentially, be verified, whereas merger control requires *ex ante* investigations into the likely future position of the merging parties and market conditions. Structural factors which are likely to persist for some time into the future and the perceivable dynamic factors of market development require more attention in merger control.

In the three years of its application, a classical procedure has emerged for case analysis under the Merger Regulation. It generally includes three major steps:[1]

(i) the determination of the relevant product market;

(ii) the determination of the relevant geographic market;

(iii) the assessment of the compatibility of the merger with the common market, that is, the question of dominance. Four elements regularly feature in an evaluation of whether a merger creates or strengthens a dominant position: the market position of the merged firm (taking account of market share and other advantages over competitors), the structure of supply (the strength of remaining established competition), the structure of demand (the buying power of customers), and the potential competition (new market entry or entry by the manufacturer of a related product or capacity expansion by established competitors).

In the application of the Regulation to oligopolistic dominance the possibility of past interaction between the companies concerned is also taken into account.

Role of economics

In the development and application of a method of merger control, the role of economics is twofold. On the one hand, it provides a basic motivation for merger control by analysing potential static and dynamic inefficiencies which may be caused by market power. At the same time, other, populist, motives for merger control stem from wider concern about the economic and political power of trusts. On the other hand, economics has to provide a paradigm for the link between the lasting change in market structure caused by a merger and future market performance. The effectiveness of a merger control authority depends to a large extent on the ability of economics to predict with reasonable probability whether a merger will harm given economic and/or political objectives.

The predominant paradigm of merger control between the 1950s and the 1970s was the structuralist approach,[2] which presumes causal and, in principle, identifiable links between market structure, conduct and performance. In the presence of barriers to entry which are seen as frequent and substantial it claims a reliable, continuous (generally linear) positive relationship between concentration and market power. Market power in turn is seen to result in uncompetitive performance, in particular in prices above competitive levels. The implicit point of reference is perfect competition which is characterized by the absence of any influence of an individual firm on its sales price and therefore at least static efficiency. The prominence of structural elements in the assessment of mergers at Community level and the emphasis — in particular by the Court of Justice — on market shares indicate that the structuralist approach has been very much at the root of Community merger control.

The absence from the Regulation of a presumption of dominance linked to specific market shares indicates, however, that by 1989 confidence in a simplistic application of the structuralist approach had been shaken, particularly by the massive criticism from the 'Chicago School'[3] of economists. This school believes that mergers mostly stem from the drive of enterprises for efficiency, and that in the presence of economies of scale even highly concentrated markets are optimal, not only for producers but also for consumers. Barriers to entry are seen as few, and often only temporary except when caused by government regulations. These arguments explain the thorough assessment of barriers to entry and potential competition as constraining forces in the application of the Merger Regulation. Other schools emphasize the dynamic character of competition[4] with market struc-

1 See, for example, European Commission (1993), *Twenty-second Report on Competition Policy*, Part Two, Section C.

2 Also referred to as 'theory of workable competition' or 'concentration school'. Important authors are Clark (1940), Bain (1956), Scherer and Ross (1990) and Kantzenbach (1967).

3 Stigler (1958), Posner (1976), Bork (1978). The 'theory of contestable markets' (see Section 4.3.3.4 below) belongs in that context.

4 For example Schumpeter (1952).

tures endogenous to the competitive process. The assessment of the likely past and potential future evolution of market structure is motivated by such considerations.

Since the economic debate on competition policy has put into question the structuralist approach without developing a new consensus paradigm,[1] Community merger control policy has to rely on an encompassing method. After assessing a broad range of factors shaping competitive conditions in a particular market, its decision is based on the assessment of the totality of circumstances,[2] taking into account market shares and barriers to entry, demand and supply side substitution, short and medium-term market dynamics. Porter ((1989), see Graph 12) provides an illustration of the competitive forces which determine the profitability of industry. These factors are precisely those which are analysed in the assessment of dominance in Community merger control. The more factors which point to a potential increase in market power the more likely the opening of procedure, then pressure for remedies and, eventually, a prohibition. In this approach there is not a single decisive factor:[3] it is after all the final result that counts.[4]

The key problem of such a totality of circumstances approach is the weighing of the different factors. In its decisions on the Commission's assessment of dominance in the context of Article 86, the Court of Justice has given significant weight to the market share of the enterprise concerned. In its application of the Merger Regulation the Commission uses market shares as a first filter in particular to eliminate those cases which do not raise any doubt. But, as the Regulation does not provide for a presumption of incompatibility based on market shares, even very high post merger market shares can be outweighed by other factors. Such an approach tends to provide a rather comprehensive view of the circumstances surrounding a merger and permits a specifically tailored decision. But since there is a considerable degree of subjective assessment involved, it may, how-

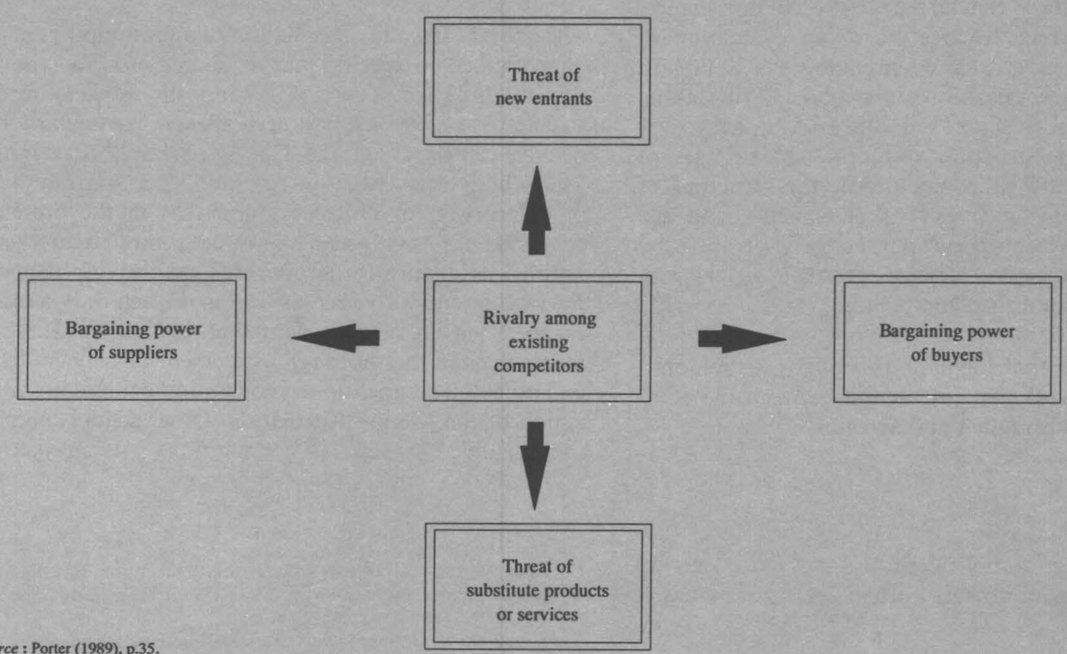
1 Kerber (1992), p. 170.

2 Which corresponds to recent developments in US antitrust policy. See Halverson (1992).

3 Claims such as market definition being the 'Achilles' heel' of Community merger control (Glais (1992), p. 99) are often not based on an overall evaluation of the Commission's assessment of dominance.

4 Korah (1990), p. 58. Similarly Bos, Stuyck and Wytinck (1992), p. 345: '... It is possible to correct a questionable approach to market definition by proper analysis of wider competitive forces'.

GRAPH 12: The five competitive forces that determine industry competition



Source : Porter (1989), p.35.

ever, also be subject to various influences (see Seabright, in Part B of this issue).

Another implication of the approach is that a prohibition is likely to be considered only in those rare cases where the large majority, if not all, of those factors point to the creation or a substantial strengthening of market power: the only prohibition so far (Aérospatiale-Alenia/de Havilland) was justified by very high market shares in a global market, high barriers to entry and the maturity of the market.[1] The sheer number of factors could introduce a bias unless each individual factor is analysed rigorously to detect a potential for the creation of market power.

As an alternative to the evaluation of a series of factors which could enable merging enterprises to obtain market power, it may be worth considering making an estimate of their pre- and post-merger market power directly. An important attribute of market power is the ability of an enterprise to increase its profits by raising the price of its product above marginal cost — the benchmark provided by perfect competition — without losing a proportional number of sales. The extent of this market power depends on the elasticity of demand faced by the firm. This results both from the willingness of customers to switch away from a product after a rise in its price (demand-side substitution) and the impact of the pricing reaction of its competitors (supply-side substitution). More formally: the residual demand elasticity or own-price firm demand elasticity is the sum of its own-price product demand elasticity (keeping the prices of all other products constant) and the sum of the cross-price elasticities with regard to competing products times the relative change in the price of competing products.[2] The elasticities can in principle be directly estimated using econometric techniques if a sufficiently large dataset of prices, costs and sales of the product concerned and its competitors is available. If reasonable assumptions can be made concerning the reaction of competitors, and post-merger elasticities can be presumed unchanged from pre-merger elasticities, the degree of market power obtained by a specific merger can be calculated. No explicit definition of markets would be required. Data permitting, the net of potential competitors could be cast widely. It would only remain to set a benchmark for the maximum increase in market power to decide on a concentration case. While such a direct approach is not used by any merger authority, the growing availability of large data sets, for example computerized sales data from supermarkets, could render it feasible for specific products.

But even if the data problems can be overcome within the time constraints of merger control procedures, such a direct approach is still liable to be incomplete: reactions of competitors other than on prices (for example by advertising) are more difficult to capture, so are the reactions of potential entrants where no past behaviour can be observed. Other elements of market power beyond the ability to raise price are also difficult to capture in a direct estimate. Without the traditional exploration of the circumstances of the merger, a merger control authority would thus lack confidence in the outcome of the calculations. The concept of direct estimation of market power does, however, provide a rigorous structure for the selection and analysis of individual factors. Furthermore, numerical estimates of own-price and cross-price elasticities would be valuable in their own right, both to direct further investigations and to cross-check more qualitative assessments.

4.3.2. Market definition

The starting point for the Commission's assessment of a concentration case is the identification of the relevant market in its product and geographical dimension. With regard to the relevant product market there is no definition provided by the Regulation itself, but a brief definition is given in the standard notification form (form CO) annexed to the Commission's implementing Regulation (No 2367/90 of 25 July 1990). The approach developed by the Commission identifies those products 'reasonably substitutable' for those of the merging firms which overlap and thus may create the possibility to exercise market power. Two basic criteria are distinguished with which separate relevant product markets can be established: lack of sufficient substitutability between the products concerned and existence of different conditions of competition albeit the products themselves being fully interchangeable or even identical.[3]

Substitutability is first and foremost analysed from the demand-side, i.e. with regard to potential alternatives for the consumer. It takes into consideration 'all those products which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use'.[4] Factors used to assess substitutability are the physical characteristics of the products in question (emphasized for example between nylon

[1] The decision even took note of the minimal efficiencies submitted by the parties although it left open whether this factor was actually relevant for Community merger control.

[2] Sleuwaegen, Part B of this issue, and Neven, Nutall and Seabright (1993), p. 22.

[3] European Commission (1992), *Twenty-first Report on Competition Policy*, p. 357.

[4] Aérospatiale-Alenia/de Havilland (M48), paragraph 10.

fibres and other fibres in Du Pont/ICI), the intended end-use (civilian and military helicopters in Aérospatiale/MBB), substantially different prices (between bottled waters and soft drinks in Nestlé/Perrier). Sometimes, but not systematically, supply-side substitutability is also considered, i.e. whether suppliers have the facility to easily switch production to the product field in question.[1] In most cases supply-side substitutability has been taken into account as potential entry for the assessment of dominance.

Even products which are technically substitutable, or even identical, are sometimes distinguished on the grounds of different conditions of competition, i.e. different structures of supply and demand. Batteries[2] and car components,[3] for example, were distinguished between those sold as original equipment and those sold as replacement. Conversely, quite heterogeneous products may be considered a group in the same product market when marketed along the same channel of distribution (for example the wholesale motor-vehicle distribution service covering in the same way different sizes of cars[4]).

Having delineated a relevant product market, the Commission turns to the geographic area in which actual, and to some extent potential, suppliers of the identified products compete. Factors to be analysed for the definition of a geographical reference market are provided by the Merger Regulation in Article 9(7):

'The geographical reference market shall consist of the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because, in particular, conditions of competition are appreciably different in those areas. This assessment should take account in particular of the nature and characteristics of the products and services concerned, of the existence of entry barriers, of consumer preferences, of appreciable differences of the undertakings' market shares between the area concerned and neighbouring areas or of substantial price differences.'

In the decisions, supply and demand characteristics are taken into account, such as the geographical distribution of market shares, the geographical distribution of relative prices, geographical location of major suppliers, shipment patterns, cross-border imports and exports, barriers to entry (fiscal, technical, regulatory, cultural), consumer preferences, transport costs, distribution systems, product differentiation (brands) and the impact of forthcoming changes, for example in the technical or regulatory environment.

The latter is a particularly important aspect in the Community context with the removal of market barriers in the internal market. The elimination of barriers to trade in the not too distant future will probably lead to the joint consideration of previously separate national markets.[5]

Both for product and for geographical markets the Commission draws conclusions on the basis of the list of characteristics it has identified. None of the above factors, on its own, determines the analysis.[6] Both the factors considered and their weights vary from case to case. In a substantial number of cases no decision on the relevant market is taken at all if it is found that, even under the narrowest definition, no creation or strengthening of a dominant position could be established.

The economic definition of a relevant market

The delineations of relevant markets for merger control have been the subject of substantial debate and controversy in economic literature. Sleuwaegen (1993, in Part B of this issue) summarizes its current state. The debate has served to clarify the concept and the role of different methods applied in practice.

Economic discussion tends to move towards a concept of market which is specific for the purpose of merger control. The traditional notion of a market has emphasized arbitrage, that is the mechanism tending to produce price uniformity. According, for example, to Stigler's (1942, p. 92) paraphrase of Marshall's definition, 'a market for a commodity is the area within which the price tends to uniformity, allowance being made for transportation costs'.[7] Several statistical tests

1 Wider definitions of the relevant market due to supply-side substitutability have been adopted, for example, in Continental Can/Viag, Lucas/Eaton, Streetly/Tarmac, Avesta/British Steel and Air France/Sabena.
2 In Magneti Marelli/CEAc and Varta/Bosch.
3 In Mannesmann/Boge.
4 Inchcape/IEP.

5 Mannesmann/Hoesch and BTR/Pirelli, but not in Accor/Wagons-Lits.
6 Jones and Gonzalez-Diaz (1992), p. 116, with regard to the definition of the relevant product market. This obviously applies to the geographical market as well.
7 Quoted in Werden/Froeb (1991), p. 1.

implementing this notion of economic markets[1] have been developed, all based generally on correlations of price levels or price changes among potential market members over time.[2]

The concept of economic markets is, however, of limited use for merger control. Merger control has to apply a market definition related to its specific task, that is to verify whether a concentration would be likely to create or increase market power for the enterprises involved. Starting from the products and geographical areas in which the merging parties actually (and potentially) overlap, the relevant market for the purposes of merger control has to be the smallest set of products and geographical areas a hypothetical monopolist would necessarily have to control to effectively exercise some degree of market power. Such an antitrust or relevant merger control market need not be the same as an economic market. An economic market will, for example, be smaller than a relevant merger control market if potential competition from firms not presently engaged in sales subject to arbitrage with the products in question constrains the incumbent producers. The relevant market, then, includes the potential competitors while the economic market does not.[3] Also, in cases where firms compete in different economic markets with costs that are interrelated across these markets (multi-market competition), the relevant merger control market has to take into account several economic markets.[4] On the other hand, an economic market will be larger than a relevant merger control market if a producer in an economic market is prevented from exercising market power; for example, for lack of capacity. The relevant merger control market would have to exclude that producer.[5]

This concept of the relevant merger control market provides a rigorous analytical framework for the delineation of a market in a specific case if market power is defined as the ability to raise prices above marginal costs. The economic logic is similar to the direct estimation of market power developed above; the latter is concerned with the question: what level of price increase would two merging enterprises be able to sustain given the reactions of their customers and their competitors? Based on the same concept, the definition of a relevant merger control market starts from the smallest product and geographical space affected by a merger (the candidate market), and asks what price a hypothetical monopolist would be able to sustain given the reactions of customers and competitors outside the candidate market. The circle of products and the geographic area is widened until the price-cost margin of the hypothetical monopolist exceeds a significance threshold.

This analytical framework permits us to put into perspective different practical approaches to identifying a relevant merger control market:

(i) The market power of a hypothetical monopolist in a candidate market, and thus the relevant merger control market, can in principle be directly estimated. Its price-cost margin is a direct function of its residual demand elasticity. This is, in turn, the sum of the partial elasticity of demand (keeping the prices of all other products constant) and of the effects of price adjustments and/or the adjustments of other marketing instruments for other goods outside the hypothetical monopolist's market in response to a price change in the candidate market. Cross-price elasticities can be used to estimate the partial elasticity of demand but they may be distorted if there is already market power in a candidate market (see Sleuwaegen in Part B for a detailed discussion). Direct estimation of relevant markets requires large data sets and advanced econometric methods.

(ii) Interviews can provide a qualitative notion for the elasticities involved — the US merger control authorities rely to a large extent on this technique. The question to be put to consumers and actual and potential competitors would be: 'if there was a monopolist in this candidate market and if it were to try to exercise market power,[6] would it be able to sustain it for a significant length of time?' The main problem with this approach results from the fact that the interviewed parties may have their own interests in the outcome of the procedure: competitors may either expect to benefit from the price increases resulting from a merger and thus suggest high cross-price elasticities with products outside the candidate market, or the opposite, if they are concerned about the predatory power of the merging enterprises. Retailers may be worried about their buyer power. Final consumers may be poorly informed about alternatives, especially if they buy products infrequently. Interviews are nevertheless a rich source of information on the competitive relations affected by a concentration.

1 Scheffman/Spiller (1985), pp. 10-11.
2 For an assessment see Baker (1987) and Sleuwaegen (1993).
3 Scheffman/Spiller (1985), p. 4.
4 Sleuwaegen (1993), Part B of this issue, which also includes an application of the concept of the antitrust market on Belgian industries.
5 Similarly the relevant merger control market may be quite different from the appropriate market definition for other Community policies (for example industrial or trade policies).

6 US merger guidelines (see footnote 2 on p. 56) specify more specifically 'a small but significant and non-transitory increase in price', usually in the order of 5%.

Their results are not often explicitly presented in EC merger control cases,[1] but they strongly influence the choice and weighting of observed market characteristics.

(iii) Market characteristics provide the most indirect approach to the definition of markets as they are based on judgment rather than on observed or reported behaviour.[2] As presented above, they provide the bulk of evidence in Community merger control cases. They have to be seen in the light of their contribution to answering the question about whether market power could potentially be exercised in the suggested relevant market. For example physical characteristics as well as price differences by themselves provide less of an indication than the use of different products from the point of view of a consumer. For products which are part of daily consumption, market demand tends to be less responsive to price increases; this characteristic would therefore indicate a narrower market definition. So do switching costs and transportation costs.

The concept of the relevant merger control market also puts into place the question of supply-side substitution. The constraints on a hypothetical monopolist in a candidate market may equally come from customers as from other producers. Other producers may react to price increases in a candidate market by attempting to enter the candidate market with a new product. The market power which could be exercised and therefore the delineation of the market depends on the time and on the irreversible investments (sunk costs) required for entry (see the more detailed discussion of entry in the context of the assessment of dominance below). Those potential new producers which would enter before the chosen threshold for market power is reached have to be considered part of the relevant merger control market. In practice interviews, observations of past entry and estimates of barriers to entry can be used to estimate potential entry into a candidate market.

The importance of taking supply-side substitution into account in the definition of the relevant market depends mainly on the weight given to market shares in the assessment of dominance: where a decision hinges on market shares, capacities which may easily be converted to produce in the relevant market have to be taken into account. The question is less significant when market shares are only one important factor which is assessed in the light of other factors, and in particular potential new competitors, as for EC merger control.[3] Nevertheless the inclusion of supply-side substitution in market definition prevents merger control from overlooking those mergers which create or strengthen market power by eliminating a competitor who is not currently in the market, but whose threat of entry acts as an effective constraint. The initial test whether products of merging parties overlap to identify a horizontal concentration has to take such potential competition into account.[4]

4.3.3. Dominance

Once the relevant market has been defined, the Commission assesses the creation or strengthening of a dominant position. It first establishes the potential market power of the merging firms on the basis of their future market position. Market shares and other advantages over competitors are considered both with regard to the immediate post-merger situation and with regard to likely dynamic market developments. Afterwards three factors of countervailing power are considered which could constrain the market power of the merging firms: the strength of the remaining existing competition, the buying power of customers and potential competition.

4.3.3.1. Market shares

Market shares have a privileged position in so far as they regularly provide the starting point for the assessment of dominance. Their importance has been stressed by the Court of Justice on several occasions. In *Hoffmann-La Roche* the Court stated that:

'the existence of a dominant position may derive from several factors which, taken separately, are not necessarily determinant but among these factors a highly important one is the existence of very large market shares ... The view may legitimately be taken that very large shares are in themselves, and save in exceptional circumstances, evidence of the existence of a dominant position'.[5]

1 For example in Nestlé/Perrier results of a survey with retailers were used as one element of evidence to exclude soft drinks from the relevant market (OJ L 356, 5.12.1992, p. 4, paragraph 14).

2 Neven, Nutall and Seabright (1993), p. 57.

3 'Provided that pressures from outside the market selected as relevant are taken into account, few firms need be found dominant that do not have power over price. On this view the definition of the market is not as important as the Court said in *Continental Can*' (Korah (1990), p. 67). Similarly Bos, Stuyck and Wytinck (1992), p. 345: 'As Alcatel/Telettra and Elf/BC/CEPSA demonstrate, it is possible to correct a questionable approach to market definition by proper analysis of wider competitive forces'.

4 Kerber (1992), p. 124.

5 Case 85/76 [1979] ECR 461, paragraph 41.

Pre- and post-merger market shares are therefore always established.[1] Their calculation is mainly on the basis of sales in the relevant market in the most recent year for which data can be obtained. In a few cases supply-side substitution has been taken into account in the calculation of market shares (see above). Post-merger shares result from simple addition of pre-merger shares. Likely dynamic developments of the post-merger market shares are taken into account later in their assessment.

Post-merger market share is helpful in indicating the outcome of an assessment only in those cases where it is below 25% of the relevant market: in such cases Recital 15 of the Regulation provides a clear presumption that the concentration is of no concern. The Commission has never opened a procedure against a merger in this range. Beyond 25%, no straightforward link between market share and the outcome of the assessment can be observed. Jones and Gonzalez-Diaz (1992, pp. 133-134) hesitatingly suggest a guide to the relationship between market shares and the likely finding of dominance. They have defined four categories: below 25% a finding of single firm dominance is almost inconceivable, between 25 and 39% rare but not excluded. They expect most findings of dominance in the range between 40 and 69% although the strength of actual and potential competition has equal weight.[2] Market shares above 70% are likely to be taken as a very strong indication of dominance.

There are indeed indications that a critical assessment is more likely in cases of above 40% market share. The lowest post-merger market share which has involved an intervention by the Commission (either by accepting commitments in the first stage or by opening procedure) was Du Pont/ICI with 43%. The importance of the 40% level is further underlined by the fact that in a number of cases remedies were accepted which brought the post-merger market share down to 40% or just below (Magneti Marelli/CEAc, Du Pont/ICI, Nestlé/Perrier). A second critical level appears to emerge at a post-merger market share of 60%. The highest market share which remained completely unchallenged was 59% in British Airways/Dan Air. Above 60% the merging firms either had to commit themselves to modifications in their intended merger or the Commission opened procedure. But even market shares above 60% did not trigger an automatic prohibition. In Courtaulds/SNIA with 65% the Commission accepted commitments in the first stage which did not directly alter post-merger market shares. In Alcatel/Telettra with a post-merger share of 83% the procedure was closed under conditions which also did not impose an immediate change in market share. In Tetra Pak/Alfa-Laval in spite of a 90% market share the procedure was closed without conditions as no increase in market share was found. In the only prohibition so far (Aérospatiale-Alenia/de Havilland) a post-merger market share of 64% was considered a strong indication for a possible dominant position but did not in itself constitute sufficient evidence. But the number of cases which created serious doubts is still quite small. The particular circumstances of individual cases may qualify any intention of the Commission to apply an increasingly strict judgment to instances of high post-merger market share.

Clearly, the general methodological approach based on a consideration of all relevant circumstances prevents a mechanical link between post-merger market share and the assessment of dominance.

Factors which help to determine the perspective on observed market shares are:

(i) The nature of the market in question: market shares are less entrenched in dynamic markets with high rates of technological development and rapidly changing structures. Furthermore in markets with high rates of innovation temporarily high market shares do not necessarily indicate market power. Such qualifications reduced the perceived risk stemming from high market shares in merger cases concerning the computer industry (Digital/Kienzle and Digital/Philips) as well as information technology (ATT/NCR). On the other hand, the maturity of the market for commuter aircraft strengthened the danger expected from the high post-merger market shares in Aérospatiale-Alenia/de Havilland.

(ii) The stability of the market share: stable, entrenched market shares may point to market power (Tetra Pak/Alfa-Laval). On the other hand there may be indications that the post-merger market shares are likely to be smaller than the added pre-merger shares, for example if the main clients are public purchasers which pursue a double-sourcing policy (Alcatel/Telettra, Mannesmann/Boge, ABB/BREL and Du Pont/ICI).

(iii) Other factors which could give the merged companies particular competitive advantages compared to remaining competitors are also considered, such as the financial power of the merged firm, scale economies, other cost advantages, the ability to supply a complete product

[1] Except obviously in those cases where no market had to be defined as even under the narrowest definition no threat of dominance could be found (see above).

[2] In cases related to Article 86 the Court has accepted post-merger market shares of 60% or more *(Hoffman-La Roche)* and 50% *(AKZO III)* as proof of the existence of a dominant position, in the absence of exceptional circumstances.

Table 27

Market shares and decisions

Case (with details)	Post-merger market share[1] (%)	Pre-merger market shares[1] (%)	Decision[2]
Air France/Sabena (Brussels - Lyons; pre-remedy)	100	50 and 50	6(1)(b) with conditions
Tetra Pak/Alfa Laval	90	90 and 0	6(1)(c) 8(2) without conditions
Accord/Wagon Lits	89		6(1)(c) 8(2) with conditions
Alcatel/Telettra (microwaves)	83	18 and 65	6(1)(c) 8(2) with conditions
Mannesmann/Hoesch (gas pipelines)	> 70		6(1)(c) 8(2) without conditions
Courtaulds/SNIA (Western Europe)	65	32, 10 and 23	6(1)(b) with conditions
Aérospatiale - Alenia/de Havilland (40-59 seats)	64	45 and 19	6(1)(c) 8(3)
Magneti Marelli/CEAc (pre-remedy)	60	40 and 20	6(1)(c) 8(2) with conditions
British Airways/Dan Air	59	50 and 9	6(1)(b)
Fiat Geotech/Ford New Holland	58	6(1)(b) with conditions	
Renault/Volvo (trucks)	54,3	46,4 and 7,9	6(1)(b)
Aérospatiale/MBB	52	44 and 8	6(1)(b)
Air France/Sabena (Brussels-Lyons; post-remedy)	50	50 and 50	6(1)(b)
ABB/BREL (diesel units in EC)	50	15 and 35 (estimate)	6(1)(b)
Rhône-Poulenc/SNIA	48	42 and 6	6(1)(b)
Nestlé/Perrier (pre-remedy)	47,5	15,6 and 31,9	6(1)(c) 8(2) with conditions
Varta/Bosch	44	22 and 22 (estimate)	6(1)(c) 8(2) with conditions
Du Pont/ICI (pre-remedy)	43		6(1)(c) 8(2) with conditions
Magneti Marelli/CEAc (post-remedy)	40	40 and 20	6(1)(c) 8(2) with conditions
Du Pont/ICI (post-remedy)	38		6(1)(c) 8(2) with conditions
Nestlé/Perrier (post-remedy)	36,8	15,6 and 31,9	6(1)(c) 8(2) with conditions
Digital/Kienzle	26	22 and 4	6(1)(b)
Alcatel/AEG Kabel	25	12 and 13	6(1)(b)

[1] In some cases, market shares are not published for reasons of business confidentiality.
[2] Article 6(1)(b) Merger Regulation = cleared; 6(1)(b) with conditions = cleared with conditions; 6(1)(c) = opening of procedure; 8(2) = cleared after procedure; 8(2) with conditions = cleared after procedure with conditions; 8(3) = prohibited.

Sources: Neven, D., Nutall, R. and Seabright, P. (1993), pp. 102 and 103; OJs; Wirtschaft und Wettbewerb; Competition Law in the EC, European Mergers.

range, provision of full after-sales service, access to technology, position in terms of quality and technology, vertical integration and brand image resulting from a tradition of high advertising expenditure.

4.3.3.2. The strength of the established competition

The first of the countervailing factors examined by the Commission concerns the ability of the remaining enterprises to act as sufficiently effective competitors to ensure that the merging firms will not be able to act independently. The analysis examines the relative economic strength of the remaining competitors with a view to their practical ability to compete. Important indicators are:

(i) The gap in market shares: in general, the larger the gap between the merged companies and the next strongest enterprise in the relevant market[1] the higher the probability that the remaining smaller enterprises will cease competing effectively. Very large gaps have been used as additional indicators of dominance for example in Magneti Marelli/CEAc, Varta/Bosch, Aérospatiale-Alenia/de Havilland.

(ii) But market share alone is not sufficient to describe the constraining effect of remaining competitors. Even small maverick competitors may, due to their inventiveness, resources and aggressively competitive behaviour limit the market power of the merged firm. Furthermore the remaining competitors may actually constitute toe-holds of leading producers in other geographical markets which may be expanded rather easily.[2] Other factors which therefore have to be assessed are in particular the spare capacity and/or significant financial and material resources of the remaining competitors in so far as they would facilitate a competitive reaction. A different aspect is emphasized by Williamson (see Part B) who observes that for multi-product companies which compete in several markets toe-holds can be an instrument to induce collusive behaviour.

All merger control authorities take the structure of the remaining competitors into account in their assessment of a merger. A difference of perspective exists, however, with regard to the role assigned to them. The concept of countervailing power leads EC merger control to see a merger less critically if there are other strong competitors in the market. US merger assessment is based on a measure (the Herfindahl-Hirschman index) which adds the squared market shares of all enterprises in the market and provides a presumption for a negative assessment, the higher the level and the increase in the index.[3] In that framework the existence of strong competitors with significant market shares would serve to raise *ex ante* the level of the HHI and would bring any merger in that market closer to a negative result. The difference is due to some extent to the preoccupation of EC merger control with single firm dominance, whereas US policy is more concerned about the risk of collusion among a few major firms.

4.3.3.3. Buyer power

The potential market power of merging firms can also be constrained by the market power of customers. The ability of strong buyers to play off suppliers against each other may maintain the competitive pressure. Strong buyers may also be able to affect market structure itself by encouraging new entrants — most easily from neighbouring geographic markets. Buyer power has been a decisive factor in the Commission's approvals for Alcatel/Telettra, Viag/Continental Can and Alcatel/AEG Kabel despite very high post-merger market shares. The effectiveness of buyer power as a constraint on merging parties depends to a large extent on the remaining competitors and/or the facility of market entry.

Furthermore it is not sufficient to show that buyers may be able to exercise countervailing power. The other important question concerns their incentives to actually put constraining pressure on the merging parties. Buyer power usually emerges in situations where the buyers are not the final customers. The incentives of buyers then strongly depend on the pressures they face in the end-user markets. Large chains of supermarkets may exercise very strong pressures on their suppliers if they themselves are faced with effective competition. On the other hand, for enterprises with publicly granted monopoly rights in their end-user markets (for example in telecommunications or energy supplies) incentives depend largely on the priorities and effectiveness of the regulating authorities. If those enterprises can pass on their costs rather easily in higher prices, they are likely to prefer stable relations with suppliers, reliable service and acceptable technical standards over low input prices. Their role as countervailing power is then likely to be limited, at least as long as their special rights are likely to persist. With a trend

1 If the merged company will not hold the largest market share in the market, a finding of single dominance is highly unlikely.

2 In Mannesmann/Hoesch the merging firms held more than 70% market share in the sector of gas pipelines in Germany. The next remaining competitor held less than 10%, all others less than 5%. But among these competitors were major European steel producers such as Hoogovens, Ilva, British Steel and Usinor Sacilor.

3 See footnote 2, p. 56.

in the Community towards limiting special rights to essential public services and exposing other previously protected enterprises to competitive pressures, the purchasing behaviour of the latter may already change in anticipation of the actual change in the regulatory regime. Furthermore the introduction of EC public procurement rules which oblige public enterprises to invite offers from suppliers Community-wide, and which permit unsuccessful companies to seek legal redress will gradually[1] increase pressures on public enterprises to purchase more competitively.

4.3.3.4. Potential competition

The third factor of countervailing power taken into account for EC merger control is potential competition. A credible threat of entry by companies not currently operating in the relevant market may deter a merged firm from exercising market power, even if it has a strong position within the relevant market. The Commission has therefore accepted the creation of a dominant position 'if there exists strong evidence that this position is only temporary and would be quickly eroded because of high probability of strong market entry. With such market entry the dominant position is not likely to significantly impede effective competition within the meaning of Article 2(3) of the Merger Regulation'.[2] In Alcatel/Telettra, Courtaulds/SNIA, Air France/Sabena and Mannesmann/Hoesch the strength of potential competition was highly important to permitting the merger, in spite of the very high market shares of the merged firm. In Aérospatiale-Alenia/de Havilland evidence of high barriers to entry was a central element in the negative decision.

The examination of potential competition focuses on the speed of potential entry, its probability and its strength.[3] Many barriers can reduce speed and probability:

(i) Regulatory barriers: national legislation may provide absolute barriers[4] where they protect State monopolies (in Elf/Ertoil and Elf/BC/CEPSA the distribution of petroleum products in Spain was legally monopolized). Licensing requirements (for example for suppliers of gas pipelines in Mannesmann/Hoesch) may be overcome but can severely delay entry. National technical standards and product norms impose additional costs.

(ii) The size of the investment required to create a viable competitor: highly capital-intensive industries or products requiring large investments in R&D and human capital, economies of scale and scope all require a large investment if the entrant is to compete effectively.

(iii) The reversibility of investments: the higher those costs of entry which are sunk (i.e. which cannot be recovered when, for example, the merged firm reacts aggressively against a new entrant), the less likely entry will be.

(iv) Advantages for the firms already in the market may stem from difficulties for entrants to set up new marketing, distribution and service facilities, from long-term contracts with suppliers or customers, control over scarce raw materials or patents. Brand loyalty for heavily advertised products may also be difficult to overcome.

(v) Transport costs are a key factor for the entry of companies present in neighbouring geographic markets.

The barriers involved are evaluated against an entrant's potential for capturing a sufficient share of demand. Factors considered include the maturity and the absolute size of the market.

In addition to evaluating the factors which generally condition the likelihood of entry into a specific market, the Commission sometimes attempts to establish whether entry of some identified candidates would actually occur, and under what conditions.

There are no explicit thresholds for potential competition to be considered sufficient. Barriers to entry are only partially quantified (for example with regard to transport costs). Also the time-limit is not defined. In Aérospatiale-Alenia/de Havilland it was estimated that new entry would require six to seven years and would therefore not be able to restrain the merged firms. But in Lucas/Eaton a time requirement of two years was not found to exclude a certain constraint on the behaviour of existing manufacturers. In Mannesmann/Hoesch the likely persistence of legal and technical barriers due to different specification requirements for some four years did not preclude the expectation of effective potential competition, given the considerable incentives for entry.

1 A key factor will be the availability of Community technical norms and standards which are forthcoming with quite different speed in the different areas.

2 Aérospatiale-Alenia/de Havilland, paragraph 53.

3 Similar to the USA where the antitrust authorities require entry to be 'timely, likely and sufficient in its magnitude, character and scope' (see footnote 2, p. 56).

4 Community regulations have been found to the same effect in the context of the common agricultural policy (sugar quotas excluded entry in Eridania/ISI).

The theory of contestable markets

The recognition by merger control authorities that enterprises outside the market in question may constrain enterprises from exercising market power similarly if not equally to competitors within, has its strongest economic backing in the theory of contestable markets.[1] This theory provides an economic concept to explain the behaviour of companies in markets characterized by scale economies where only a few suppliers can operate at a size which minimizes production costs (minimum efficient scale). In these markets allocative and productive efficiency cannot be ensured by price-taking as in perfectly competitive markets. Entry is the behavioural postulate replacing price-taking in the theory of contestable markets.[2] With free entry, markets with economies of scale will be efficient. The challenge to traditional merger control is obvious: in the theoretical concept of perfectly contestable markets there is no presumption that high market shares lead to inefficient market performance which renders traditional merger control based on market shares completely irrelevant.[3] It also puts into question any attempt to define a market: a narrow definition would have little meaning as many actors outside would perfectly constrain the enterprises inside, a wide definition aiming at including all potential entrants would — if entry was free — be infinite.

The relevance of the theory of contestable markets for practical merger control policy depends on the extent to which it provides a reasonable descriptive approximation to reality. The key theoretical concept is free entry. Entry is considered free if there are potential competitors with the same cost functions, who can enter and exit without loss of capital within the time-frame required for incumbents to change prices. Where entry requires no investments which are at least partially irreversible (sunk costs), or only sunk costs which can be fully recovered in a time period before the incumbents can react by, for example, lowering their prices to drive out the entrant, the threat of such 'hit-and-run entry' will be sufficient to enforce efficiency. But the strong theoretical conclusions become less robust if these assumptions are not met.

In the presence of even a small amount of sunk costs, enterprises outside the market do not constrain behaviour inside the market as well as already established competitors. Their impact can be expected to be lower the higher the sunk costs, and the longer it takes for entry. The deterrent effect of potential hit-and-run entrants may be so strong as to justify their inclusion in the market definition, as the Commission has done in a few cases under supply substitution. If they are not part of the market definition, they may be included, as the US authorities include them, in the calculation of market size. But as some cost elements are always sunk, there is a continuum of potential competition which differs according to the cost and time needed to create new productive capacity or to alter existing capacity.[4] The distinction between supply substitution and entry may therefore not be very useful in practice.

Empirical studies suggest that the rate of entry is higher when pre-entry profits are high, when demand is growing rapidly and when barriers associated with scale economies and product differentiation are low.[5] Possible counter strategies of the incumbents have to be assessed in order to evaluate the probability of entry. Advertising, patent production, filling of available product niches or maintaining excess capacity are used to create strategic barriers to entry. Profitability may be disguised to keep outsiders uninformed about market conditions.

The most likely means of entry is often trade (see Williamson, Part B). Potential imports are likely to act as an effective discipline where the possible supplier has spare capacity, sunk investment in distribution and marketing, little need to redesign its product and low contracting, transport and transaction costs.

4.3.3.5. Oligopolistic dominance

Dominance has so far been discussed with regard to the risk of a single firm obtaining, or increasing market power by means of a merger. But it cannot be excluded that a concentration creates or reinforces a situation in which a few legally independent firms may, taken together, exercise market power with similar consequences for the Community economy (oligopolistic dominance).

The legal question whether the Community Merger Regulation applies to the creation or strengthening of oligopolistic dominance is still being debated by lawyers, even though the Commission has no doubt on this point. The text of the Regulation only refers to the creation or strengthening of a dominant position without specifying whether it also covers market situations in which more than one firm together could exercise market power. The Commission has assessed the potential creation of oligopolistic dominance in Fiat Geotech/Ford New Holland, Varta/Bosch, Alcatel/AEG Kabel and Thorn EMI/Virgin. As it came to a negative

1 Baumol(1982), Baumol and Willig (1986).
2 Spence (1983), p. 982.
3 Neven, Nutall and Seabright (1993), p. 41.

4 Salop and Simons (1984), p. 680.
5 See Scherer and Ross (1990), pp. 392-393 for references.

conclusion on substance it left the jurisdictional question open. In Nestlé/Perrier, however, it found that 'the merger between Nestlé and Perrier (followed by a sale of the Volvic source to BSN) would create a duopolistic dominant position on the French bottled water market ...'.[1] The Commission then took the decision to apply the Regulation to cases of oligopolistic dominance. It was concerned in particular about the threat of a loophole in the fundamental Community objective of maintaining effective competition if a division of market power among two or more companies would render Community merger control inapplicable. Furthermore as all major national antitrust systems can be applied to both single-firm and oligopolistic dominance, it could not be presumed that by transferring authority for large mergers to Community level the Member States actually desired to abandon such control. A majority in the Advisory Committee on Concentrations[2] shared the Commission's view that the Regulation can be applied in the case of a collective dominant position.[3] The concentration was cleared only after Nestlé had committed itself to sell a sufficient capacity of sources to permit the creation of a viable third force in the market.

Economists have known for a long time[4] that where the number of firms in a market was limited, their interaction could, under certain conditions, lead to inefficient market performance similar to a monopoly. Mergers reducing the number of independent enterprises may create or increase the risk of such an outcome. Under different conditions, however, even a duopoly with only two companies in the market can result in efficient performance. A reduction in suppliers short of the creation of monopoly would then not create market power.

The key economic characteristic of an oligopoly is that the number of enterprises in the market is so limited that they are to some extent mutually interdependent, i.e. their strategic decisions have to make assumptions about the potential reactions of other firms. Under certain conditions they may believe it to be in their interest to choose a strategy as if they were maximizing profits jointly with the other firms. A wide range of theoretical models has been developed to derive market performance on the basis of different oligopoly structures (symmetric or asymmetric), instruments used (prices, quantities, advertising, product differentiation, ...) and reactions assumed. Under certain assumptions a clear link between post-merger concentration measured by the HHI and market power can be derived.[5] Such conclusions, however, do not stand up well to changes in the model. The complexity of oligopolistic interaction, therefore, permits only the identification of structural factors and strategic behaviour which may facilitate collusion.

For merger control policy the additional aspects of oligopolistic interdependence can be assessed separately from the possibility of creating or strengthening dominance in the relevant market. A finding of oligopolistic dominance would be the result of a two-stage test. First, the assessment of mergers possibly leading to oligopolistic dominance has to evaluate whether the merged company and a few rivals could jointly exercise market power if they colluded perfectly, i.e. behaved as if they were a single company. As for single-firm dominance, the importance of market share, the effectiveness of the remaining competitors, buyer power and potential competition define the upper limit of potential market power. Second, as the firms remain independent actors their collusion will be less than perfect, and the upper limit of market power may not be attained. The risk of collusion depends on the structural opportunity to do so and the incentive for individual companies to cheat without risking retaliation. Past behaviour may provide important insights in these structural factors, in particular if oligopolistic interdependence is likely to have occurred already before the merger.

Williamson (1993, see Part B) discusses many of these factors.[6] Oligopolistic collusion may be more likely, for example, if the number of remaining firms is small and they are of equal size, if markets are transparent, or the market is mature and little innovation and product development can be expected, if the product is homogeneous, if production costs are similar and if purchases are frequent. Business practices may be aimed at improving the possibility of collusion and at signalling adherence to jointly profit-maximizing behaviour. Such behaviour may include recognition of a price leader, publication of price lists, formal price rounds and mutual acceptance of market shares. The relative weight of each factor is subject to debate and different schools persist (see Williamson, Part B of this issue). An interesting line of study also concerns the possibility of identifying preliminary filters for selecting merger cases which raise serious doubts on oligopolistic dominance, given the time constraints on practical merger control.

1 OJ L 356, 5.12.1992, p. 28, paragraph 131.
2 The Advisory Committee on Concentrations consists of representatives of the authorities of the Member States. It is to be consulted on all cases for which Article 6(1)(c) proceedings have been opened. Its rules of operation are defined in Article 19(3) to (7) of the Merger Regulation.
3 OJ C 319, 5.12.1992, p. 3, paragraph 3.
4 A first formal model to describe oligopolistic behaviour was proposed by A. A. Cournot in 1838.
5 Scherer and Ross (1990), p. 200.
6 See also Kantzenbach and Kruse (1987), Scherer and Ross (1990).

The assessment of oligopolistic dominance is of particular importance for the Community in the context of the completion of the internal market. In some important markets the result of the restructuring process will be the predominance of a few firms in the Community market, rather than the dominance of a single firm. This is particular likely where single companies have operated until now along purely national lines (for example: airlines, telecommunications, utilities). Only Community control over the creation or strengthening of oligopolistic dominance can assure an effective system of undistorted competition.

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Annex

Competition policy in the European Community

1. Introduction

Fair competition is one of the basic principles upon which the European Communities were built. At the very beginning, the Treaty establishing the European Coal and Steel Community (ECSC) in 1952 provided for a far-reaching Community competition policy for these sectors, stipulating for example that 'subsidies or aids granted by States in any form whatsoever' and 'restrictive practices which tend towards the sharing or exploiting of markets' are incompatible with the common market for coal and steel (Article 4 ECSC) and that 'the Community shall ensure the establishment, maintenance and observance of normal competitive conditions' (Article 5 ECSC). The Treaty of 1957 establishing the European Economic Community (EEC) calls in its preamble for 'concerted action in order to guarantee... fair competition', and Article 3(f) EEC identifies 'the institution of a system ensuring that competition in the common market is not distorted' as one of the activities of the Community.

The objective of competition policy at Community level was from the beginning to ensure effective competition to allocate resources efficiently and to create the best possible climate for fostering innovation and technical progress. The prospect of a Community competition policy to provide a level playing-field in a common market also encouraged Member States to waive their rights to use trade policy measures against intra-Community trade.[1] Community competition policy was considerably strengthened in parallel with the completion of the internal market as 'the expected benefits of the single market, including increased productivity, lower prices and greater employment opportunities, will not be realized unless free and fair competition is fully maintained in the post-1992 Community'.[2] The EEC Commission communication on 'Industrial policy in an open and competitive environment'[3] recognizes 'the maintenance of a competitive economic environment' as one key element upon which the industrial policy concept of the Community should be built. The Treaty on European Union signed in Maastricht on 7 February 1992[4] reconfirms this consensus by making the economic policy of the Community explicitly subject to the 'principle of an open market economy with free competition' (Articles 3a EC and 102a EC). Furthermore it insists that policies which may be introduced on the basis of a new Treaty title on industry must be 'in accordance with a system of open and competitive markets' (Article 130(1) EC) and shall not 'lead to a distortion of competition' (Article 130(3) EC).

To ensure the maintenance and strengthening of competition, the Community disposes of a range of instruments. In their broadest sense, they include the breaking-down of internal and external barriers to trade: the internal market programme for example exposes a wide range of previously nationally protected and regulated markets to intra-Community competition. Policies to facilitate the creation and development of new enterprises also strengthen competition in the Community.

As far as competition policy proper is concerned, the Community disposes of instruments to intervene against anti-competitive behaviour both by enterprises and by national governments, if trade between Member States is affected. With regard to enterprises, Article 85 EC prohibits agreements or concerted practices between two or more enterprises (cartels), which prevent, restrict or distort competition within the common market. Article 86 EC prohibits abusive behaviour by firms which are in a dominant market position. Furthermore, since 21 September 1990 a new Merger Regulation[5] prohibits concentrations which would create or strengthen a dominant position. With regard to national governments, Articles 92 to 94 EC authorize the Commission to decide whether or not subsidies granted by public authorities in the Member States to specific enterprises are compatible with the common market. Furthermore, Article 90 EC stresses that the competition rules apply equally to publicly owned enterprises unless they are entrusted with providing a public service. It is increasingly used to limit monopoly rights of public enterprises to the indispensable minimum.

1 Article 91(1) EEC permitted anti-dumping measures against Member States, but only for the transitional period until the common market was fully established. From the moment the Treaty went into force, Article 91(2) EEC has imposed on Member States the obligation to permit unrestricted reimportation of products, thus effectively preventing dumping within the Community.

2 European Commission, 'EEC competition policy in the single market', *European Documentation* 1-1989, p. 6.

3 COM(90) 556 of 16 November 1990, *Bulletin of the European Communities*, Supplement 3/91, p. 5.

4 Council and Commission of the European Communities, *Treaty on European Union*, 1992.

5 Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentration between undertakings, OJ L 257, 21.9.1990, pp. 13-25.

2. Community competition rules for enterprises

2.1. Anti-competitive agreements (cartels)

Article 85 EC prohibits practices and associations between undertakings or firms 'which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market'. It covers agreements, decisions by an association of enterprises (for example a trade association) or so-called concerted practices with the purpose of aligning the activities of the enterprises involved. Examples of such prohibited agreements are price fixing between competitors, agreements on market shares or production quotas, or export bans. The prohibition of Article 85 applies both to horizontal agreements between enterprises at the same level of commercial activity (competitors), and to vertical agreements, such as agreements between manufacturers and the distributors of their goods.

Regulation No 17 of 1962[1] on the implementation of Articles 85 and 86 EC provides parties to an agreement which may violate Article 85 EC with the possibility of seeking a declaration from the Commission that their activities do not come within the scope of Article 85. Such negative clearances can be given in individual cases, provided the parties have notified their agreement to the Commission. Furthermore the Commission has issued notices on certain activities which it does not consider *per se* to be an infringement of Article 85. For example:

(i) Agreements of minor importance (the *de minimis* rule): agreements between small and medium-sized enterprises whose combined share of the relevant market is less than 5% and whose aggregate turnover is below ECU 200 million are normally not considered as violating the competition rules.

(ii) Agreements on activities which are not anti-competitive: the Commission has established over time a list of activities which — under certain conditions — it does not consider anti-competitive. Examples include: joint market research, joint research and development projects, joint use of production, storage and transportation equipment or joint after-sales and repairs services by non-competing firms.

If agreements do fall under Article 85, the general rule is that they are null and void from the outset. Enterprises engaged in such activities can be ordered to stop and can be fined by the Commission up to ECU 1 million or 10% of their annual turnover, whichever is larger.

The prohibition of Article 85 can, however, be declared inapplicable by the Commission if the harmful effects of a restrictive agreement or practice are sufficiently counterbalanced by a number of beneficial elements. Article 85(3) lists four conditions which must all be met before a so-called exemption can be granted by the Commission:

(i) the agreement must contribute to an improvement in production or distribution, economic or technical progress;

(ii) a fair share of the resulting benefits must be passed on to consumers;

(iii) only restrictions to competition which are indispensable in order to achieve the beneficial result will be allowed;

(iv) competition must not be eliminated for a substantial part of the goods or services in question.

Where an agreement meets these four requirements, an exemption can be granted, either on an individual basis or by way of a group exemption. Group exemption regulations exist at present for agreements relating to specialization, exclusive distribution, exclusive purchasing, patent licensing, research and development, distribution in the automobile sector, franchising and know-how licensing. Agreements which meet the requirements set out in the regulations need not be notified to the Commission.

2.2. Abuse of a dominant position

Article 86 EC prohibits 'any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it' in so far as it may affect trade between Member States.

The elements necessary for application of Article 86 are:

(i) The enterprise(s) must be in a dominant position. Dominance is understood as a position of economic strength which allows an enterprise to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers.[2] Market share is a major element in assessing dominance: a share below 25% normally precludes a finding that a single enterprise

[1] OJ 13, 21.2.1962.

[2] European Court of Justice in *United Brands* [1978] CMLR 429.

is dominant, but extremely large market shares may constitute in themselves, but for exceptional circumstances, proof of a dominant position.[1] Other factors examined are for example the enterprise's research and development, patents, financial resources, the distribution system, the position of other competitors, barriers to entry and buyer concentration.

(ii) The dominant position must be in the common market or a substantial part of it. In one case, for example, the southern part of Germany was considered substantial, in another, it was Belgium. But a substantial part of the common market also refers to a part of the market for the relevant product, in economic terms.

(iii) There must be an abuse of the dominant position, in the sense that advantage is taken of the dominant position which causes injury to third parties, or the firm holding the dominant position acts in a manner which tends to eliminate competition through unjustifiable means. Examples provided in Article 86 EC are imposing unfair purchase or selling prices or other unfair trading conditions, limiting production, markets or technical development, applying dissimilar conditions to equivalent transactions and making the conclusion of contracts subject to acceptance of supplementary obligations which have no connection with such contracts.

Activities of enterprises which fall under Article 86 can be stopped by the Commission and can be subject to fines similar to those applied under Article 85. Enterprises which are in a dominant position can seek legal security for certain activities by requesting a negative clearance of the Commission as provided for by Regulation No 17 of 1962 (see above).

In the absence of a specific provision on merger control at Community level in the EEC Treaty,[2] the EC Commission, backed by the Court of Justice, extended the application of Articles 85 and 86 to certain mergers. In the *Continental Can* case of 1972[3] the EC Court of Justice held that an abuse in the sense of Article 86 may be committed where an undertaking already in a dominant position strengthens or extends that position by acquiring control of another undertaking. In the *BAT and Reynolds*[4] case the Court held that agreements on the acquisition of shareholdings in competitors fall within Article 85 where they influence the market behaviour of the firms concerned so that competition between them is restricted or distorted. But their application was difficult and limited to specific cases. When the Merger Regulation[5] was adopted in December 1989, the Commission declared that in future it does not normally intend to apply Articles 85 and 86 to mergers falling under the Regulation. It reserved the right to apply them to smaller mergers which do not have a Community dimension as defined by the Regulation thresholds as long as the total turnover of the parties involved exceeds ECU 2 000 million and the Community-wide turnover ECU 100 million. But in the first three years of application of the Merger Regulation it has not done so.

3. Community competition rules for national governments

3.1. Community control of national State aids[6]

From the foundation of the European Communities it was also clear that intervention of national governments in favour of some of their enterprises could threaten the efficient distribution of activity between the Member States and thus the gains expected from the liberalization of trade in the common market. The governments therefore decided to tie their own hands in this respect and to give to the EC Commission far-reaching control over national State aids.

For coal and steel Article 4 ECSC declares that 'subsidies or aids granted by States ... in any form whatsoever' are incompatible with the common market and must 'accordingly be abolished and prohibited within the Community'. The strict prohibition of State aid in these sectors could, however, not be sustained as the pressures mounted for national aids to facilitate the thorough restructuring of these sectors. To maintain a coherent approach which particularly avoided a bidding-up of national aids, the Commission — with unanimous approval from the Council[7] — authorized aid frameworks, first for the coal industry (since 1965) and later for the iron and steel industry (since 1980). The

1 In *AKZO* v *Commission* (Case 62/86), for example, the Court of Justice considered that a market share of 50% fell into that category.
2 This is in contrast to the ECSC Treaty of 1952. It contains detailed rules for mergers (Article 66 ECSC) which grant the High Authority exclusive jurisdiction and wide-ranging powers of implementation.
3 Case 6/72, OJ C 68, 21.8.1973, p. 33.
4 Joined Cases 142 and 156/84, OJ C 329, 8.12.1987, p. 4.

5 See footnote 5, p. 73.
6 For a more comprehensive overview of Community State aid policy, see 'Fair competition in the internal market: Community State aid policy', *European Economy* No 48, September 1991. A collection of legislation and policy statements concerning Community State aid policy is available in *EC competition law, Volume II: Rules on State aid*, European Commission, Brussels, 1990 (new edition scheduled to be published in 1993).
7 On the basis of Article 95 ECSC.

currently applicable rules for iron and steel[1] limit aid to research and development, environmental protection, costs of plant closures and to investment in Greece and the new German *Länder*, provided they do not lead to an increase in capacity. For the coal industry a much wider range of aids are permitted under certain conditions, including aid to cover operating losses, investment aid and employment aid.[2] The current framework authorizing aid to the coal industry expires at the end of 1993.

For most other sectors of the Community economy,[3] Article 92 EC lays down the general principle that State aids, in so far as they distort trade between Member States, are forbidden unless a derogation (i.e. an exception) is specifically accorded. Possible derogations are enumerated in paragraphs 2 and 3 of Article 92 EC. To obtain such a derogation Member States have to notify the EC Commission of any plans to grant aid to their enterprises (Article 93 EC). The Commission may use its power of injunction to stop national governments granting aid before a Commission decision has been taken. Only if the Commission decides that a national State aid is compatible with the common market can aid be legally granted. When the decision is negative, aid that has already been allotted to an enterprise has to be repaid with interest.

The scope of Community control of national State aid is wide. Given the high and increasing degree of integration of the Community's economy, most national subsidies are likely to be considered trade-distorting — even for products which are not exported to other Member States, if they compete on their home market with imports from other Member States. Furthermore Article 92 EC covers aid from all public bodies, or agencies acting on their behalf, at national, regional or local level. It applies to all enterprises, regardless whether they are privately or publicly owned. The form of the aid is irrelevant: for example outright grants, soft loans, tax concessions, guarantees, the supply of goods or services at less than cost are all subject to Community State aid control. But it does not address government measures which have no element of specificity such as general economic, fiscal or social policy.[4] In any case, should there be doubt about whether a government transfer in favour of an enterprise constitutes State aid in the sense of Article 92 EC, it is up to the Commission to decide.

Having decided that a measure constitutes State aid with an actual or potential distorting effect, the Commission then has to determine whether a derogation from the general prohibition of aid can be applied. Derogations are foreseen in the Treaty for:

(i) social aid to individual consumers, provided that it is granted without discrimination as to the origin of the products concerned (Article 92(2)(a)),

(ii) 'aid to make good the damage caused by natural disasters or exceptional occurrences' (Article 92(2)(b)),

(iii) aid to some regions of Germany (Zonenrandgebiet and West Berlin) to compensate for the economic disadvantages caused by the division of Germany (Article 92(2)(c)),[5]

(iv) regional problems (Articles 92(3)(a) and 92(3)(c)),

(v) important projects of Community interest (Article 92(3)(b)),

(vi) a serious disturbance of a Member State's economy (Article 92(3)(b)),

(vii) 'aid to facilitate the development of certain economic activities' (Article 92(3)(c)), and

(viii) other categories of aid specified by decision of the Council (Article 92(3)(d)).[6]

Aids which fall in the three categories of Article 92(2)((i) to (iii)) are automatically considered compatible with the common market. The Commission has no discretion to disallow such aids. As for the other possible derogations, the Commission has to determine, from the point of view of the Community as a whole, whether the benefits to be expected from the granting of aid outweigh the disadvantages, in particular, but not exclusively, the potential trade distortion.

To specify more clearly its application of the Treaty provisions on State aids and to codify its policy, the Commission has issued numerous guidelines. They can be divided into

1 Commission Decision 3855/91/ECSC of 29.11.1991.
2 Commission Decision 2064/86/ECSC.
3 Except agriculture and fisheries (Article 42 EC) and public transport (Article 77 EC).
4 Such general measures are not presumed in principle to be incompatible with the common market. Should there be the risk that a general measure distorts competition, the Commission can propose appropriate measures on the basis of Articles 101 and 102 EC which require, however, unanimous adoption by the Council.

5 With the unification of Germany the application of that derogation is coming to an end.
6 Very little use has been made of that derogation. The main instances concern shipbuilding and some agricultural products.

two main categories: horizontal and sectoral. The horizontal rules are concerned with particular forms of aid or types of aid schemes and ensure that the Commission has adequate information. Sectoral rules provide specific provisions for sectors which are particularly sensitive.

An example of horizontal rules for an often used derogation is the rules on regional aid. The Treaty provides for possible derogations for areas with an abnormally low standard of living or serious underemployment (Article 92(3)(a)) and for 'certain economic areas' (Article 92(3)(c)). In its application the Commission insists that a differential of regional subsidization is created in favour of the least developed regions of the Community to strengthen its regional cohesion. Commission guidelines therefore specify in detail the Community regions which may be eligible in either category. The respective ceilings for national State aids are set country by country by individual decisions. Under Article 92(3)(a) aid for investments in the least developed regions of the Community may be up to 75% of the cost and, under certain conditions, temporary operating aids may also be granted. In practice, however, the 75% ceiling is rarely reached as the countries concerned lack the necessary financial resources. Article 92(3)(c) is applied by the Commission to allow wider possibilities for regional aid to counter regional disparities within a Member State, but even here the Community context is taken into account. Ceilings for investment aid are fixed individually but are mostly no higher than 30%. No operating aid is permitted.[1]

Other horizontal guidelines concern research and development, small and medium-sized enterprises, the protection and improvement of the environment and the rescue and restructuring of ailing firms.

For certain sectors, detailed rules on State aids have been laid down either by the Commission or by the Council. Such specific sectoral rules exist for aids to coal and steel, agriculture and fisheries, transport, shipbuilding, synthetic fibres and motor vehicles. Except in the case of transport, the most important problem taken into account is that of persistence over capacity. As a general principle the rules stipulate that aid for investment which would increase the output of the products in question has to be strictly limited or is even forbidden outright. Furthermore all sector specific rules insist on degressivity of any sectoral aid.

[1] A separate guideline specifies procedures for the cumulation of different aids.

3.2. Community surveillance of national public enterprises

Enterprises which are directly or indirectly owned by the national public authorities require special consideration from a Community competition policy point of view. On the one hand public enterprises often supply public goods (for example health care, education, defence) which are not adequately provided by private enterprises under market conditions. These tasks require public funds and/or special privileges (for example monopoly rights). On the other hand other activities of public enterprises are purely commercial. Special support for them would distort intra-Community competition. In practice the distinction is not always easy to draw: within one sector (for example telecommunications) some activities may have the character of public goods and require public privileges (for example the provision of a basic telecommunications network), whereas other activities can certainly be performed competitively (for example the supply of end-user equipment).

The EC Treaty is neutral with regard to private or public ownership of enterprises (Article 222 EC). But it underlines in Article 90(1) EC, that 'in the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measures contrary to the rules contained in this Treaty ...'. Such enterprises thus have in principle the same obligations as private firms, in particular those defined by the competition rules.

An exception is, however, made for those public enterprises 'entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly' (Article 90(2) EC). For such public-utility undertakings the rules of the Treaty, in particular those on competition, apply only to the extent that they do not 'obstruct the performance, in law or in fact, of the particular tasks assigned to them'. But even for such enterprises the exceptions from the Community competition rules must not affect the development of Community trade to an extent contrary to the interests of the Community. It is for the Commission to apply this Article.

The Commission has put emphasis on three aspects:

(i) transparency of the financial relations between States and their public enterprises,

(ii) partial deregulation of public monopolies, and

(iii) dismantling of commercial State monopolies.

Transparency of the financial relations between States and their public enterprises is a prerequisite for an effective application of the Community rules on national State aids to public enterprises. In fact, to assess whether a financial transfer from a government to a public enterprise constitutes a State aid in the sense of Community law, the Commission has to establish whether the government has acted as a market economy investor, i.e. has provided the funds on terms which a private investor (or lender) would find acceptable when investing in or lending to a comparable private undertaking under normal market economy conditions. Otherwise the transfer may include State aid. In a Directive of 1980[1] the Commission therefore obliged the Member States to supply the Commission, at the Commission's request, with information on public funds made available directly or indirectly to public undertakings. As the Commission nevertheless still had to deal with a number of cases involving unnotified aid to public companies, the transparency requirements were strengthened and made more systematic: since 1993 all public companies in the manufacturing sector with an annual turnover exceeding ECU 250 million have had to provide annual reports to the Commission on the financial flows between them and the public authorities.[2]

Another area of concern for competition policy, as far as public enterprises are concerned, are those markets, where governments have granted public enterprises statutory monopoly protection. Such exclusive monopoly rights are awarded for various public policy reasons, such as ensuring security of supply, providing a basic service to the whole population or avoiding the costs of duplicating an expensive distribution network. Such practices are common, notably for utilities (energy and water), postal services, telecommunications and to some extent in broadcasting, transport (air and maritime), banking and insurance. These exclusive rights prevent, however, the creation of a real internal market for a significant part of national production. The Commission recognizes that the operation of services of general economic interest (in the sense of Article 90(2) EC) must not be prejudiced. But it is examining on a sector-by-sector basis whether less restrictive practices are possible, how to limit statutory monopoly rights to the essential activities and whether competing services could use existing networks or new technologies would permit the construction of alternative networks. To implement its conclusions, it has increasing recourse to Article 90 EC either through directives or decisions. One example is the Commission Directive of 16 May 1988 on free competition on the Community markets in telecommunications terminal equipment (modems, telex terminals, private satellite stations, etc.).[3] It prohibits immediately any exclusive rights to import, market, connect, bring into service and maintain such equipment. Furthermore, the regulatory power held by national telecommunications authorities is to be separated from their commercial activities. Similarly, Commission Directive of 28 June 1990 on competition in the markets of telecommunications services[4] provides for the abolition of the exclusive rights for the supply of telecommunications services other than voice telephony. Other Commission activities in this context concern, for example, preparatory work on a Green Paper on postal services, various efforts to establish a genuine single energy market in gas and electricity, exclusive rights of national airlines to provide ground services during stopovers at national airports, betting organizations and job-placement agencies.

Another area of surveillance of national public enterprises concerns State monopolies of a commercial character, which directly or indirectly supervise, determine or appreciably influence imports or exports between Member States. Article 37 EC requires Member States to adjust such monopolies to ensure that 'no discrimination regarding the conditions under which goods are procured and marketed exists between nationals of Member States' (Article 37(1) EC). Although those adjustments should have been completed by 1970, there were considerable difficulties in implementing this rule, in particular as far as lucrative national monopolies were concerned such as tobacco or alcohol monopolies, or with regard to questions of national security concerning oil monopolies. On 20 March 1991 the Commission decided to open infringement proceedings under Article 169 EEC against those Member States which still grant exclusive import and export rights for gas and electricity.

[1] 'Directive on the transparency of financial relations between Member States and public undertakings' (80/723/EEC) of 25 June 1980, OJ L 195, 29.7.1980.

[2] Commission Directive 93/83/EEC of 30 September 1993. OJ L 254, 12.10.1993.

[3] Commission Directive 88/301/EEC, OJ L 131, 27.5.1988.

[4] Commission Directive 90/388/EEC, OJ L 192, 24.7.1990.

Part B

Expert studies[1]

[1] The views expressed by the authors are personal and do not necessarily reflect those of the European Commission.

Regulatory capture, subsidiarity and European merger policy

P. Seabright

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1. The theory of regulatory capture

1.1. Introduction

Academic and political contributors to the discussion of the role of the State in economic management have in recent years reached a rare degree of consensus on one point: regulating the operation of the State's own organs and agencies is as central to the task of good government as is governing the activities of the private sector of the economy. It is no longer possible to regard government agencies as staffed by selfless and omniscient upholders of the common weal, nor to contrast them with the simple and ruthless pursuit of profits by private firms. For one thing, it has become abundantly clear that government agencies themselves respond to political and economic pressures and incentives, and that limitations on the information available to them may severely constrain the policies they can pursue; for another, the fact that firms may themselves be run by agents with interests of their own other than maximizing shareholders' wealth has become much harder to ignore. One of the tasks, therefore, for both firms and government agencies is to ensure that the individuals running them have incentives to do so in the wider interests of the parties whose welfare they affect.

What has become known as the theory of regulatory 'capture' attempts to describe the various influences on regulatory agencies to represent special interests rather than some idealized conception of the common good. There are two main components to this theory. The first, which has its origins in Marx's view of the influence of business interests over the State, but which was given significant impetus by the work of Stigler (1971), emphasizes that interest groups have various means to influence public decision-makers, both elected politicians and unelected officials. These means include direct bribes, indirect monetary inducements through campaign contributions, the hope of public decision-makers for future employment after they leave office (the 'revolving door'), the influence of voting lobbies in marginal constituencies, and — not least — the subtle influence exercised by proximity, through public officials' wish for good relations with the interest group representatives with whom they daily have to deal.[1] Though the study of regulatory capture is relatively modern, the phenomenon itself is not: Foster (1993) reports that Gladstone's attempts to regulate private railway companies in Britain in the 1840s were obstructed by the immense lobbying power of railway companies, who at one time numbered 132 MPs as directors.

In Stigler's work capture was conceived as subordination of the regulatory process to the interests of firms in the regulated industry, but more recent contributions (surveyed in Noll, 1989) have considered capture by many kinds of interest groups (including consumer safety and environmental lobbying groups, for instance). And one can also contrast industry capture with government capture (an instance of time inconsistency where the government is unable to commit itself not to interfere in the regulatory process for short-term electoral considerations, such as to preserve employment in firms threatened with reorganization in marginal constituencies). Both industry and government capture have their origins in a more fundamental notion, which can be called bureaucratic capture: when the aims of a regulatory agency come to reflect the individual aims of its staff — for larger budgets, a higher media profile, an enhanced reputation for winning legal cases, or whatever else those aims may comprise.[2] It is by working to influence these aims that interest groups can appropriate the regulatory process to their own ends. All these contributions imply that regulation will create and distribute rents, usually by restricting entry to the markets concerned.

The second component of the theory (particularly emphasized by Laffont and Tirole (1993), Chapter 11) focuses on the constraints inherent in the regulatory process. These comprise both the asymmetries of information that prevent the public at large from checking the actions of regulators and thus make capture possible (Laffont, 1993); and the constraints that nevertheless keep regulators from abusing their discretion and therefore keep capture in check. In particular, any analysis must take account of the fact that most design of regulatory institutions is undertaken not by the ultimate principals (the voting public at large) but by politicians and officials who are themselves agents with delegated powers and whose incentives in designing institutions may in turn differ from those of the principals. In other words, regulation (like all political activity) involves hierarchies of delegation, and raises the question: who regulates the regulators? The upshot is that no system of regulation can ever be completely proof against regulatory capture. Awareness of this problem has motivated much of the liberalization and deregulation in many countries in the 1980s. Where continued regulation has been thought nevertheless to be justified, several general principles have been advanced as helping to diminish the risks of capture.

[1] It should be evident that capture is by no means to be equated with corruption, and many of the mechanisms of capture are not ones that could reasonably be prevented by the criminal law — especially since the risk of error makes very large penalties undesirable.

[2] For an account of utility regulation that incorporates the individual aims of regulators, see Evans and Garber (1988); for empirical evidence that lawyers in the US Federal Trade Commission have been systematically more keen than other officials to initiate legal proceedings, see Coate and McChesney (1992).

1.2. Different responses to regulatory capture: accountability, independence, transparency

One such principle is the principle of accountability: the idea that regulatory agencies should be held to account through the political process to the general public. In theory this means that greater political scrutiny should help to counterbalance the natural inequality in the ability of different interest groups to influence regulatory practice, including the well-known tendency for consumer interests to be less well organized than those of producers.[1] In practice it has meant: a greater attention to the oversight of regulatory bodies by legislative committees (such as the House of Commons Select Committees in the UK); arguments for increasing the powers of the European Parliament relative to those of the Commission; the incorporation of procedures such as environmental impact assessments into the practice of some government agencies (especially in the United States); scrutiny of regulatory proposals via institutions such as the US Office of Management and Budget and via publication (e.g. in the Federal Register) to invite public reaction; increased public funding for a number of bodies concerned with safety, consumer affairs and the environment; increased resort to public enquiries on contentious regulatory matters; and improved procedures (such as the establishment of ombudsmen) for representing public grievances.

A second general principle, paradoxically the apparent opposite to the first, is that of political independence. It has become particularly popular in recent years as a prescription for central banks (see Persson and Tabellini (1993)), though it was also influential in the establishment of sectoral regulatory agencies for the newly privatized utilities in the UK. It is based on the sentiment that politicians may be the source of more regulatory capture than they remedy; and it refers not to a complete absence of political accountability but rather to the view that such accountability should be exercised at occasional intervals and through clearly pre-specified criteria rather than on a day-to-day basis. There are really two distinct theoretical foundations for such a view. The first is that regulation faces a problem of time-inconsistency; regulators would like the industries they regulate to invest optimally, but politicians will be more tempted than independent regulators to seek to expropriate any rents accruing to such investments after they have been made. The second is the claim that the ability to exercise day-to-day influence is much more unequally distributed between different interest groups than is the ability to exercise influence at pre-determined and infrequent intervals. While the former consideration is undoubtedly more important for utility regulation (where the perceived problem is usually one of discouraged investment through populist disapproval of utility profits), the latter is more relevant for regulation of mergers and for competition policy in general (where political pressures are more likely to err in the direction of under-representation of consumer interests).

A third general principle is that of transparency, which implies that regulatory agencies should be obliged to make public as much as possible the information and reasoning upon which their decisions and actions are based. The case for transparency rests on three conceptually distinct arguments. First, by making more information public that might otherwise be private, it may reduce the informational asymmetries that give rise to the possibility of capture in the first place. Secondly, transparency can aid a regulatory agency to commit itself (and, by extension, can aid those establishing such an agency to commit it) to a given regulatory policy by increasing the visibility of any departures from such a policy. Thirdly, one of the greatest sources of inequality in the influence exercised by different interest groups is the cost of gathering information, both about the issues concerned and about the nature of the regulatory process itself (and therefore about where influence may most effectively be exercised). Some interest groups (such as large firms) may gather such information as a by-product of their other activities; they may also have more at stake and may therefore be better able to spread the fixed costs of doing so. Not only does information have some of the properties of a public good, in that the cost to the regulatory agency of publishing it once it has been acquired may be very small. But, in addition, the benefit of its publication to any particular interest group is proportional to the cost that that group would have had to incur to acquire it otherwise; enforcing publication therefore tends to offset some of the original inequalities in influence due to the cost of private information acquisition.

Independence and transparency are not entirely separate principles but are intimately linked. First, effective transparency of regulatory procedures depends upon agencies' possessing at least enough independence to be able to resist pressures to modify what they publish to suit the preferences

[1] Ironically, some of the earliest economic theories of the State (Downs, 1960) assumed that political influence was wielded by voting, and that the interests of the (actual or potential) median voter therefore had a disproportionate influence on policy-making. Such theories had some difficulty in explaining why producer interest groups usually appear to wield more power than consumers, since corporations as such have no votes (though employees of certain corporations in marginal constituencies may have very vital votes). Later theories of rent-seeking activity (Krueger, 1974) emphasized the financial resources of producer groups; the effectiveness of spending resources (including time) on lobbying is likely to be highly non-linear, thereby disadvantaging those interest groups whose members have less at stake per capita.

of those to whom they are politically responsible. Secondly, if regulatory agencies are notionally independent but the government retains (as it almost always does in a democracy) the right to override what the agency does, it is only the adverse publicity that such overriding would receive that will prevent a government from overriding the agency whenever it wishes to. Some economists have, indeed, thought it inconceivable that separate branches of government could continue to have disparate goals, presuming that the subordination of all such branches to a single central authority would be irresistible (see Hayek (1944), p. 64 and the discussion of this claim in Stigler (1988), pp. 141-147). It is only the presence of sufficient transparency to ensure that attempts to subordinate the branches receive adverse publicity, therefore, that can add substance to any formal constitutional provision of independence.

These principles remain somewhat abstract; the theory of regulatory capture can nevertheless shed light on some more immediately practical questions of regulation design.

1.3. The assignment of regulatory powers

1.3.1. How centralized should regulation be?

The question whether regulatory powers should be exercised at the level of European Community institutions or those of Member States (or indeed those with even more local jurisdiction, such as the German *Länder* or the French Départements or Communes) has become one of the most contentious political issues of recent years in the Community. The principle of subsidiarity which appears in the Maastricht Treaty has often been criticized for vagueness, but it represents in fact a criterion for determining the burden of proof which has a great deal of theoretical and practical weight behind it. It states simply that regulatory powers should be exercised at the most local level unless there are compelling reasons for centralization. It does not in itself specify what those reasons might be, but there is by now a growing literature discussing exactly that. Its theoretical foundation is Tiebout's model (1956) of the provision of local public goods.

Tiebout's model showed that competition between localities in the supply of public goods would lead to an efficient allocation, given a number of conditions, of which the most important (and restrictive) were the following:

(i) costless mobility of citizens between jurisdictions;

(ii) a large number of jurisdictions;

(iii) no external effects between jurisdictions.

These were in addition to technical assumptions such as that each public good has an optimal number of consumers (to ensure a determinate number of communities), and complete information about alternative possibilities. If one interprets systems of regulation as being special cases of local public goods, the Tiebout model can explain why there should be a presumption in favour of decentralization (localities are more able to obtain the form of regulation they would prefer, both through direct political accountability and through mobility of individuals and firms between localities). It can also explain when centralization is most likely to be desirable. The fact that the first two of Tiebout's conditions are unrealistic provides in itself no reason for thinking centralization will improve on decentralization. Instead, spillover effects between jurisdictions provide the main rationale for centralization, because they imply that a centrally coordinated policy will be able to improve on the typically inefficient non-cooperative setting of regulatory policies by individual jurisdictions. However, the precise character of that rationale depends critically on the nature of the information available to the parties concerned.

Table 1 summarizes in a simplified form some of the main arguments in this literature. If there are only spillovers, and no asymmetry of information between different parties, there may be no need for centralization, since the same result can be achieved simply by agreeing a coordinated policy between jurisdictions. This policy is enforceable by the threat of any locality (a Member State, say) to revert to the non-cooperative policy if other Member States renege on their promise to implement the agreed policy. However, several circumstances may arise in which coordination will not work. One is if parties discount the future too heavily (or alternatively, interact sufficiently rarely) to make the threat of retaliation a sufficient inducement for cooperation. Another is if there is incomplete information about whether each party is keeping its side of the bargain. In either of these circumstances centralization may be necessary because of a lack of sufficient mutual trust to make the cooperative policy credible. Unfortunately, this same incomplete information could also make centralization very costly if local regulators are intrinsically better informed than central ones.

1.3.2. The functional separation of powers

1.3.2.1. The balance between sectoral and generic regulation

The last section considered the question of how powers should be allocated between different levels of government; now we consider the extent to which, at any given level, there is a case for separating different kinds of power between

Table 1

Applications of the Tiebout model to regulatory centralization

Basic model	Assumptions	Conclusions
Tiebout (1960)	No spillovers Complete information	Decentralization
Easterbrook (1983)	Few spillovers Complete information	Decentralization
Rose-Ackerman (1981)	Spillovers Complete information No repeated interaction	Centralization
Gatsios and Seabright (1989)	Spillovers Complete information Low discount rate	Decentralization with policy coordination
Neven (1992)	Spillovers Complete information High discount rate	Centralization
Klibanoff and Morduch (1993)	Spillovers Incomplete information Local regulators better informed	Decentralization unless spillovers 'large'
	Spillovers Incomplete information Local regulators not better informed	Centralization

regulatory agencies charged with different tasks. There are two aspects to this question. First, is there sometimes a case for granting to distinct agencies similar kinds of regulatory power, but exercised in different sectors? For example, the UK formed a new regulatory body for each of the privatized utilities (telecommunications, gas, water and electricity). It could instead have formed a single office of utility regulation; what considerations aside from administrative convenience might lead one to prefer one option to the other?

The chief advantage of having several sector-specific agencies lies in the possibility for comparing the performance of the agencies with each other. The literature on principal-agent relationships with several agents makes it clear that when the randomness in the circumstances affecting the outcome of the tasks is correlated between agents, relative performance evaluation acts as a spur to efficiency (Mookherjee (1985), Shleifer (1985), Holmstrom and Milgrom (1990)); the higher the correlation, the lower the agency costs of delegation. The disadvantage of having sector-specific agencies lies in the greater risk that these will be captured by producer interests.

Empirical evidence on the relative force of these two arguments is at best ambiguous. This is not least because many of the sectoral agencies that have been thought to be most captured in practice were originally established not for regulatory purposes at all, but to act as promoters of the interests of the industries concerned, which was easily confused with discharge of regulatory responsibilities as these became more important over time (see McGowan and Seabright (1992)). Neven et al. (1993, Chapter 6) review both theoretical and empirical arguments, and conclude that overall, the use of sectoral agencies may yield some advantages, especially if the goals of the agencies concerned are clearly specified and are not confused with promotional activity on behalf of the sectors concerned. But many of the benefits of comparison can be achieved with rather little sectoral division of responsibilities, and these benefits in any case depend on a significant degree of correlation in the nature of the regulatory tasks. It is certainly not evident that a sectoral division of merger control responsibilities has much to recommend it.

1.3.2.2. The separation of regulatory objectives

A second issue in the regulatory division of powers at a given level of government concerns whether different kinds of task should be performed by the same or by different agencies. For example, it has already been argued in the preceding paragraph that sectoral promotion tasks should be performed (if at all) by different agencies from those that perform regulatory tasks; the reason was that confusion between these two objectives makes it harder for political authorities to monitor whether the agencies are doing their job. Other issues concern whether the regulation of competition (which is an important part of overall public policy but is not its only desideratum) should be the concern of an agency that is separate either from the rest of government in general or from any other agencies charged with industrial policy in particular.

Two main arguments have been put forward in the literature for such separation of powers. Tirole (1993) discusses the benefits to the credibility of government action that may arise from the presence of multiple agencies, including some that have incentives to be much more tough in fiscal matters than others. The knowledge, for example, that a public project facing cost overruns will see control transferred to an agency with incentives to terminate the project even if it has positive social value, may act to discourage cost overruns in the first place (a benefit which must be set against the cost of terminating some beneficial projects). However, what is the behaviour a tough implementation of competition policy is intended to discourage? The most likely candidate is predatory action that has as its goal the weakening of rival firms to the point where being taken over by the predator is the only realistic alternative to quitting the market. The ideal solution to such a problem is more effective policing of predation, but given the well-known difficulties of doing so (see Kühn et al.(1992), Section 8), it may be that a commitment to competition goals alone (and consequently a refusal to consider the failing firm defence) could sometimes be the right second-best policy.

Nevertheless, the magnitude of the benefit from such a restriction of goals is not obviously very large, it must be said. The failing firm defence is neither an overwhelmingly persuasive nor a very common one in practical merger policy, and competition agencies have some power to distinguish mergers that are the consequence of predatory behaviour from those that are not. Furthermore, a merger that is the only means to ensure that that firm stays in the market may, for that reason, be undesirable even on overall social grounds (the failing firm's assets may be more effectively deployable elsewhere), so a rigorous application of overall public policy criteria may help to discourage some such cases in any event. And the cost of excluding all other criteria from decision-making could in some circumstances be quite large.

A second, perhaps more serious, kind of activity that independence might aim to discourage is efforts by firms to subvert its established policy (by lobbying and the mobilization of political support of various kinds). If it were successful in discouraging such activity, a formally independent agency might paradoxically need to try less hard to stick to its policy than another whose independence was more in doubt.

A second argument for separation of powers suggests that the State may wish to restrict the kind of information that an agency may legitimately take into account in reaching its decisions.[1] Most judicial systems have rules of admissibility of evidence to diminish the incentives for investigators to use duress in its acquisition. Crémer (1992) provides an additional rationale for rules of inadmissibility of certain kinds of potentially relevant information within decision-making organizations: agents whose qualities or whose projects make them indispensable may thereby become prone to moral hazard, so it may help to deny them the opportunity to demonstrate their indispensability in the first place. In the context of competition policy, limiting the agency to consider only information directly relating to the degree of competition on the market (for example, during a merger) will discourage firms from presenting other information (for example about efficiency gains) that will make them feel able to insert anti-competitive components into their merger proposals with impunity. Once again, the gains from such a restriction of information may not seem very large: agencies charged with regulating mergers can and frequently do object to aspects of a proposed merger without threatening to veto the entire proposal. However, the credibility of their objections may then be in some doubt, and some of the measures adopted by the firms to meet those objections may be more cosmetic than real; so the benefits of a restrictive information policy are not negligible. The desirability of restricting the information available to the agency will then depend very much on the perceived costs of such a restriction, and here it must be said that the costs too are not as great as one might think.

The chief reason for this consists in the likely source of the information concerning countervailing benefits (such as efficiencies in a merger case). In most instances information about the degree of competition in a market will be available from a number of sources and can be verified by cross-checking. For instance, in merger cases a firm's estimates of its market share can be cross-checked against information from competitors, consumer organizations and official sources.[2] The same cannot be said of information about efficiency gains that are internal to the firm. Here it may be very difficult for a competition agency to verify the quality of the information it receives from the interested parties. Acceptance of submissions about efficiency gains therefore creates incentives to all firms to claim that these are very large, and the information content of such claims will consequently be very low.

What this implies is not that public policy should necessarily ignore all considerations of efficiency gains, but that for an agency evaluating the public policy implications of certain developments (such as mergers), there will be few costs to a policy of treating most information concerning such gains, if it comes from interested parties, as of little or no value. Not all information does come from interested parties: in some industries with common technology it may be possible to estimate efficiency gains rather more credibly. But it

1 Of course, practical considerations will limit the information the agency can process; the question here is whether the agency itself should be free to decide what to count as the most relevant.

2 These are not identically credible. For instance, some mergers are very much in competitors' interests, so competitors may be the last parties to wish to challenge them.

makes sense to treat claims to that effect with some circumspection.

To summarize, then, a degree of independence of competition agencies (in the sense of establishing goals for such agencies that differ from those of overall public policy, plus the power to make decisions in pursuit of those goals) has some value in discouraging anti-competitive behaviour that is difficult to prevent by other means. But there is no real case for making that degree of independence very great (or to put it another way, for allowing countervailing considerations to enter public decision-making only at great political cost). Establishing a separate and transparent function for a competition agency is a different matter, and may be very important. This means that there are major benefits to the publication of the agency's deliberations and decisions, and (less obviously but still persuasively) to ensuring that the agency is not distracted in its evaluation of competition concerns by being invited to consider a large amount of information about non-competition issues. It also means that the relationship between the agency and the political authorities will be more complex than that of simple monitoring of the agency's decisions: the political authorities will need to modify those decisions from time to time to ensure that the goals of public policy are given adequate weight.

1.4. Implementation

The issues dealt with in Section 1.3 concern fundamental questions of the constitution of competition policy. To put such a policy into effect, however, requires more attention to the fine print of implementation. Three aspects of implementation will be briefly considered here. First, what kind of resources should a competition agency command? Secondly, how should the balance be determined between the speed of investigations and quality of the findings? Thirdly, what does this imply for the appropriate balance between rules of procedure and the scope for agency discretion?

The most important observation to make concerning the resources of a competition agency is that these constitute a very small fraction of the potential costs of overall competition policy. An investigation into a merger case may occupy no more than three or four rapporteurs, and there is little evidence that increasing this number would result in significantly better analysis. More importantly, significant resources in the merging firms may be required to find and analyse information, respond to questions and anticipate the reactions of the merger authorities; a large multinational firm responding to a second request for information from the US Department of Justice might easily need to use the services of around 150 paralegal staff worldwide.[1] But much of this information is what the firm would itself have needed to obtain and process before deciding whether to undertake a merger. Much of the most important cost of a merger investigation is the delay it imposes on the managerial changes than can be implemented in the merging firms: even if the benefits of a merger are likely to amount to no more than 2% of turnover, postponing these for three months for an investigation would cost ECU 25 million for the smallest transactions covered by the Community's merger regulation. It follows that resources spent enabling the agency to undertake investigations quickly with no loss of analytical quality could yield net gains of at least ECU 8 million per month of investigation time saved; such a sum can buy quite a few person-hours of time.

A more difficult judgment concerns the degree to which reductions in the quality of analysis can be tolerated in order to speed up investigations. There are two types of risk when the quality of analysis is reduced: first, that undesirable mergers will be wrongly allowed, and secondly, that desirable mergers will be wrongly prevented. Neven et al. (1993, Chapter 2) develop a model of the trade-off between these two types of risk. While the model is somewhat stylized its main conclusion appears to be robust: reductions in the time taken to approve a merger can easily be offset by a deterioration of one or two percentage points in the probability of correctly classifying mergers. The reason is that the main costs of delay are related to the failure of the benefits of a good merger to be realized during that delay (and are therefore a few percentage points of the total discounted benefits of the merger); they may therefore be offset by a deterioration of a few percentage points in the probability of classifying the merger correctly, failure to do which incurs a cost equal to the whole discounted benefit of the merger (analogous remarks apply to bad mergers).

Both the benefits and costs of individual mergers, and the probability with which these mergers will be approved, depend to a considerable extent on the nature of the bargaining process between firms and the agency. Refusal of a merger is costly, not just for the firms but also in many cases for the agency (not only will the firm and its sources of political support be angry, but the agency faces the threat of possible judicial challenge with the attendant's direct and indirect costs of time, trouble and loss of credibility if the challenge is successful). The fact that it is the firm that has the 'first-mover advantage' — since it makes proposals that the agency must accept or reject — makes it unclear why the agency would ever refuse a merger; and this knowledge may give firms the confidence to manipulate the bargaining procedure

[1] J. Ordover, personal communication.

to the maximum possible extent. The only convincing answer to this is that the agency is concerned about a loss of its reputation for objective analysis. But this answer in turn is persuasive only if the agency is committed to a set of rules of procedure, failure to abide by which can actually be observed. So in practice the difficult balance between rules and discretion in merger control depends not simply upon technical issues about the analysis of markets and so forth, but on the very fundamental consideration that a commitment to at least some rules is the only way the agency can send a credible signal to firms that it will not allow itself to be manipulated by fear of the costs of disagreement into approving whatever proposals firms come up with.

It becomes important therefore to note that it does not make sense for the agency to try to commit itself to appraisal criteria unless it actually intends to follow them. If it does not propose to follow the announced criteria, but instead to accept proposals that fall outside them, then it might as well announce different criteria.[1] This in no way implies that the merger control authority should not seek to reassure firms that it wishes to minimize the risks of failing to reach agreement. But it does imply that the proper way to do this is to design merger appraisal criteria with the costs of disagreement fully taken into account rather than to display *ex post* a lack of commitment to its prior announcement.

This section has reviewed very schematically the developing theory of regulatory capture and its remedies, illustrating it where possible with reference to competition policy in general and to merger policy in particular. It has not specifically considered the light this theory sheds on the case for merger control by the European Community, nor what form its procedures should take. These are the tasks of the next section.

2. Regulatory capture and European merger policy

2.1. The costs of capture in merger policy

In Section 1.4 above it was emphasized that the costs imposed on society by a policy of merger control consist principally not of the direct resource costs of running a competition agency, but the costs of delay imposed on firms and the costs of mistaken judgments about the approval or prevention of mergers. To these costs should be added a third kind, namely the costs due to changes in corporate behaviour as a consequence of the merger procedure: the tendency to structure deals so as to increase the probability of a favourable interpretation under the regulation, any anti-competitive behaviour induced by the desire to exploit such procedures as the failing firm defence, the discouragement of otherwise beneficial merger activity through fear of the costs or the results of the merger control process, and the blunting of any incentives for managerial efficiency induced by the threat of take-over.[2] These costs would be present to some degree even with a merger policy that was optimally designed and as immune as possible to capture. But to what extent does regulatory capture contribute to these costs?

The answer depends to a considerable extent on the source and nature of the capture concerned. Bureaucratic capture of the simplest kind — namely, where the scale and intrusiveness of antitrust activity reflect a desire for empire-building by bureaucrats — can impose costs that are potentially very large, chiefly by increasing the uncertainty and the delay to which firms are exposed. However, merger regulation is considerably less prone to this form of capture than are other areas of competition policy, since a merger is an event initiated by firms to which the authorities need to give a rapid response if the merger is not to be discouraged completely. Furthermore, pressure from industry has been quite successful in ensuring that the time-limit for merger approvals is kept low: the Community's Merger Task Force completes its second-stage inquiries within four months and first-stage ones within one month, while the UK's Monopolies and Mergers Commission has in recent years been completing many inquiries within three months instead of the previous six. This contrasts strikingly with other aspects of antitrust activity, such as the investigation of monopoly and restrictive practices. It is particularly true in the United States, where major antitrust cases usually take five to 10 years and cost both plaintiffs and defendants many millions of dollars.[3]

[1] This is not to say that there could not be a more complex justification in terms of criteria that are designed to impress parties other than firms (foreign governments, the voting public) without affecting the behaviour of firms; but the most plausible candidate explanations of this kind are not very reassuring from the point of view of the broader public interest.

[2] For example, Schumann (1988) found that the 1985 New York take-over statutes requiring greater time and information to be available to shareholders to consider tender offers both improved the benefit to shareholders of actual consummated take-overs and diminished the credibility of the take-over threat, thereby diminishing shareholder wealth overall. This is a particularly significant finding, because it is the threat of take-over rather than of actual take-over that is supposed to improve managerial efficiency. However, the take-over threat may have undesirable as well as desirable effects, and neither the theoretical nor the empirical literature has reached a consensus on which kind of effect outweighs the other.

[3] Stigler (1988), p. 165. He reports that 'in the IBM case, (it was said that) the budget by the company for the defence was not limited, but nevertheless exceeded that limit'. It must be said, however, that the high costs of US antitrust action are much more to be blamed upon the legal system than on excessive zeal of the antitrust agencies. Coate and McChesney (1992) remark on the high proportion of cases won by the FTC, which certainly suggests no inclination to initiate weak or frivolous cases.

Not only are individual cases costly but many take place solely because of the incentive effects of triple damages in encouraging speculative complaints (Boner and Krueger (1991) report that 96% of US civil antitrust suits are brought by private parties). Even in Europe the comparatively slower pace of Articles 85 and 86 investigations by the Competition Directorate contrasts markedly with the streamlined nature of the merger procedure, and has led to a number of companies' seeking to have their transactions counted as mergers (instead of as cooperative joint ventures, for example) in order to avoid treatment under the slower procedures. The outgoing Competition Commissioner, Sir Leon Brittan, has announced changes to the procedures under Articles 85 and 86, but at time of writing it remains unclear exactly what the impact of these changes will be.

Concern about the effects of capture on merger procedures do not, then, typically focus on bureaucratic capture as such. There are four common worries: first, that the procedure may be excessively captured by industry interests, so that too many damaging mergers are approved; secondly, that the procedure may be excessively prone to government capture, so that mergers which will lead to desirable rationalization of industry assets will be dissuaded by the pressure of politicians with electoral interests in the status quo; thirdly, that in an international context too many mergers are assessed by purely nationalistic criteria; and fourth, that regardless of whether the procedure shows any particular bias, lobbying by various interest groups increases the randomness in the approval process, and this randomness increases the cost of the whole procedure.

The history and political context of the Community's Merger Regulation suggest that concern about the excessive capture of Member States' procedures by national interests was one of the chief motivations for establishing the Regulation originally. This concern was expressed in a number of ways. First, many protagonists thought that national capture would simply lead to industry capture, namely to the emergence of pan-European monopolies that national authorities lacked the power or the incentive to control (especially if they could represent themselves as national or even European champions). This was a danger particularly to be feared in the context of the single market programme, which by liberalizing capital markets eased the way to trans-European corporate expansion through acquisition, and by liberalizing trading barriers gave firms the incentive to seek alternative ways to buttress their market power (see Emerson et al. (1988)). Since in response to this danger the European Commission had begun to intervene in merger cases in any event, a second concern was that of double jeopardy, namely the risk that firms would find themselves facing scrutiny from competing authorities vying with each other for jurisdiction. So the attraction of the Merger Regulation as establishing a one-stop shop for companies was a very important part of the impetus behind its passage in 1989. And thirdly, the risk of double (or multiple) jeopardy was not just that it would increase uncertainty but that the effective decision about a merger would be taken by the most restrictively inclined authority. Some parties were therefore concerned that, in the absence of the Regulation, national authorities would intervene in the passage of many quite harmless mergers on the basis of alleged threats to national interests (see Rosenthal (1992)).

So the passage of the Regulation was important not just for imposing a new European constraint on the operations of companies, but also for removing a number of (real or imagined) national constraints. Which of these two effects was the more significant is not a straightforward judgment to make. Some parties in the Commission (and outside — see Rosenthal (1992)) saw the Regulation as facilitating merger activity that might otherwise have been prevented on narrowly nationalistic grounds,[1] or simply discouraged by red tape and the risk of double jeopardy. Others have seen the Regulation as much more restrictive overall, and in particular as giving rein to a penchant within the Commission for supporting small and medium-sized firms (and by extension, for opposing the creation of large firms) as a matter of principle and regardless of the implications for efficiency (Glais (1992)).

Under either interpretation, the philosophy of the Merger Regulation contrasts markedly with that of the original antitrust legislation in the United States, and much of antitrust practice since. In the USA, antitrust activity was seen as protecting citizens from the overweening power of corporations. And economic research has tended to express concern about government rather than industry capture in the process: it has been suggested (e.g. by Coate and McChesney (1992)) that political pressures tend to distort antitrust practice in the direction of greater intervention than would otherwise occur, though to a much less marked degree in the 1980s.[2] In Europe, by contrast, the Merger Regulation has

1 And perhaps also on ideological grounds. There were some marked national differences in this: the French, in particular, were inclined to see the Germans and (in different ways) the British as dogmatically opposed either to mergers in general or to mergers of certain kinds (such as those where the acquiring company was publicly owned).

2 This needs some qualification. By political pressure, I am here referring to pressure from political sources external to the FTC and the Department of Justice (from Congress, in particular). However, the DoJ is headed by the Attorney General who is a member of the Cabinet, and the Assistant Attorney General and his deputies are all political appointees. This means that the tendency of the DoJ can be strongly politically influenced, but from its head rather than from outside. This influence during the 1980s can certainly be argued to have been determined strongly by a pro-business ideology.

been viewed at least as much as offering corporations a degree of protection against various threats. Those who see the Regulation as on balance a facilitator view the main threat against which it protects firms to be the excessive and inefficient interventionism of national governments (though to be sure, some corporations benefit from such interventionism — especially those that receive State aids or protected markets). Those who see the Regulation as more restrictive believe its main beneficiaries to be small and medium-sized firms who are thereby protected from the power of large, efficient competitors.[1] Either way, the politicians and bureaucrats responsible for the passage of the Regulation appear clearly to have believed that most corporations would benefit from the protection it offered, and could therefore expect to favour the new regime.

On balance, too, it was hoped that industry would gain more than it lost from one of the other anticipated features of the new regime, namely its greater credibility compared to the fragmented patchwork of different national competition systems then in existence. The Commission, as a supra-national body, would have greater weight in dealing with the many large multi-national corporations than would the authorities of any single Member State, and could therefore develop a more credible (and consequently coherent) competition policy (see Gatsios and Seabright (1989)). While this might lead to some firms being less able to escape the long arm of competition policy than they might otherwise have done, the overall increase in predictability should be favourable to industry overall.

It is not the purpose of this article to evaluate the extent to which the Merger Task Force's actual practice since 1990 has borne out any of these hopes and concerns. But it is worth noting the difference between the purpose and philosophy of the Merger Regulation and that of some other competition policy regimes (notably the USA), because it may help to explain the comparative absence of checks and incentives against industry capture embodied in the European system, as we discuss in Section 3.2 below. First, however, we need to review what may be concluded from the theory so far discussed about the case for European merger control.

2.2. The case for European merger control

The discussion in Section 1.3.1 has already indicated that a concern about an excessively national focus in the control of mergers is indeed one of the considerations on which a sound normative case could be based for allocating regulatory powers to a supra-national agency such as the EC Commission in spite of the presumption of subsidiarity. Whether or not mergers are allowed to take place may have significant cross-border effects for companies whose activities take place in several countries. These effects will not be adequately internalized by national agencies, and typically the costs of market power to foreign customers will be given less weight than the rents of market power to domestic interests. At one time it was commonly argued that this was principally because shareholders were less dispersed internationally than consumers. But progressive removal of controls on international capital movements has changed the extent to which this is true[2] without substantially altering the importance of the asymmetry between the costs and the rents: in effect, lobbying responds more to the location of employment and of senior management than to the nationality of shareholders. The fact remains, though, that evaluation of international mergers according to purely national criteria would not only make merger control less accurate, but would be likely to bias it towards an excessive toleration of market power.

Just as importantly, these international spillovers are ones that do not lend themselves readily to resolution via cooperation between national agencies, because of the difficulty of monitoring the extent to which any cooperative agreement is being kept. Merger assessment involves collecting a great deal of information, some of it necessarily commercially confidential, and then evaluating it according to criteria whose application cannot be routine or automatic. It is hard for other national agencies to be sure that any one of their number is observing the spirit of a cooperative agreement in any particular case without duplicating most of the work involved in the investigation. In the circumstances the temptation to cheat on any voluntary coordination of national policies is extremely strong.[3]

Fortunately, however, the asymmetries of information are not intrinsic to the international character of the problem, but are themselves dependent upon the allocation of regulatory powers. In other words, under national merger control,

1 There is said to have been vigorous lobbying of the Commission against the de Havilland merger by a number of de Havilland's competitors. The Commission has also given some ammunition to those who hold this interpretation in its decision on the AT&T/NCR case, in which possible cost savings from the transaction were considered a negative factor since 'potential advantages flowing from synergies may create or strengthen a dominant position' (see Neven et al. (1993, Chapter 3)).

2 It is likely that remaining barriers to mobility within Europe in terms of language and culture will soon be more significant for goods than they are for capital — and for labour they will be the most significant of all.

3 Stronger, certainly, than for almost any other form of international policy coordination (certainly including monetary and fiscal policy).

national authorities have private information not because they are of the same nationality as the firms under investigation, but largely because they are the ones empowered to investigate. Allocating power to a supra-national agency significantly alleviates this problem, and thereby removes what might otherwise be significant impediments to the ability of international merger control to improve on the uncoordinated national outcome.

Though the case for some EC-level regulation of mergers is a strong one, difficult questions naturally arise about where the boundaries should lie between the competences of the Community and the various national-level agencies — questions made more difficult by the different scale and differing philosophies of existing national-level competition policies. At present the boundaries are determined by the interaction of three kinds of consideration:

(i) The scale of the parties to the transaction, namely that their combined worldwide annual turnover must exceed ECU 5 billion, and that at least two of them must have EC-wide turnover exceeding ECU 250 million, if the transaction is to fall within the Community's sphere of competence. At the passage of the Regulation in 1989, the Commission expressed its wish to see the total turnover threshold reduced to ECU 2 billion when the Regulation was revised at the end of 1993.

(ii) The extent of international spillovers from the transaction, as determined by the stipulation that mergers between firms conducting two-thirds or more of their business in one and the same Member State fall outside the scope of the Regulation. This makes the importance of the spillovers in triggering EC intervention depend upon their size relative to the transaction rather than upon their absolute magnitude. If, as might seem more natural, it is the absolute size of the spillovers that determines whether national regulation will be distortionary, then any reduction in the aggregate turnover threshold may increase the potential for inconsistent treatment. For instance, under an ECU 2 billion turnover threshold, suppose two firms with a turnover of ECU 1,1 billion each in a market involving a product with high transport costs were initially in a duopoly in the Benelux region and in north-east France. A merger between them would fall under the Regulation and might very well be prevented, provided they were independent firms. Suppose, however, each were the subsidiary of a German firm with a turnover exceeding ECU 3,3 billion; the transaction would then fall outside the Regulation, even if the damage done to competition in the larger German market were judged by the Bundeskartellamt to be small enough to justify approving the merger. To avoid this kind of distortion (and the associated regulatory advantage it would create for multinational companies based in the larger EC Member States) it would be desirable for the Community to investigate transactions that give rise to international spillovers exceeding a certain absolute sum. For example, it could be stipulated that of the ECU 2 billion worldwide annual turnover (of which at least ECU 500 million takes place within the Community), at least ECU 250 million of the latter must take place outside the Member State with the largest share of the combined turnover.

(iii) A series of exceptions to the two principles above are embodied in Article 9 (the German clause), Article 22(3) (the Dutch clause) and Article 21(3) (the legitimate interests clause). The latter raises issues beyond the scope of this paper, but the first two involve important aspects of the subsidiarity question. Article 9 provides for a Member State to apply to investigate itself a merger falling under the Regulation if it fears the creation or strengthening of a dominant position in a distinct market within that State. However, Article 9 as it stands gives rise to significant ambiguities. Its chief rationale lies in the (justified) concern that the two-thirds rule for turnover thresholds does not really capture what it purports to capture, namely the extent of economic spillover effects between Member States. In particular, concentrations where the new economic entity operates independently of one or more of its parents may have an economic impact in only one Member State even though (due to the turnover of the parent being counted for calculating the thresholds) the transaction is not exempted from the Regulation by the two-thirds rule. Since it is hard to think of any simple rule that captures economic spillovers better than the turnover rule, the only solution appears to be to give the Commission discretion to judge that, notwithstanding the turnover criterion, the case involves no real economic spillovers (either costs or benefits) and may therefore be judged by the appropriate national authority if the latter so wishes.

However, the history of Article 9 applications to date (and in particular, the fact that the Commission has declined more applications than it has granted) suggests that some Member States (particularly Germany) have viewed its purpose in a somewhat different light. Under this second interpretation, Article 9 embodies a principle to the effect that one Member State should not be forced to suffer significantly damaging effects from a merger even if these are judged by the Commission to be outweighed by benefits elsewhere in the Community.[1] Since the whole point of centralizing merger control is to ensure that mergers are judged by their aggregate EC-wide effects rather than those in any one country, it is hard to see any long-term rationale for this interpretation of Article 9 based on subsidiarity considerations. Rather, its political origins appear to have lain in unallayed doubts by the German negotiators of the original text of the Regulation about the immunity of the merger control procedure to industry capture, and specifically to fears that the Task Force would approve mergers with more adverse consequences for market power than the German authorities themselves would be willing to tolerate. If there is justification in such fears, the best long-term response to them lies in strengthening the MTF's procedures against industry capture — and perhaps in measures that increase the extent to which they are seen to be strengthened against capture — rather than in the use of a measure like Article 9. And the purpose of Article 9 itself could usefully be clarified by an explanation that it is intended to apply to circumstances where the Commission judges the turnover rule to have given the misleading impression that there were significant economic spillover effects between Member States.

Related points can be made about Article 22(3), which is in any case due to be reviewed with the turnover thresholds at the end of 1993. It allows States without merger control legislation of their own to ask the Commission to apply the Merger Regulation to deals that would otherwise fall below the thresholds. While in principle a desirable transitional step, it is somewhat at odds with the spirit of the subsidiarity principle, which implies that whether Member States choose to have merger authorities or not should be a matter for the Member States themselves. A State choosing to have weak or non-existent competition regulation should be free to do so for those aspects of competition without substantial cross-border effects. Firms choosing to establish themselves there should also be able to do so in the clear ability to anticipate the regulatory regime they have to face, without fearing that the rules will be changed by a government appealing to Brussels against a merger that would not normally fall under the Regulation but which the government happens not to like. Of course, subsidiarity implies that the Member State may choose to change the rules if it wishes, but there is no reason for the European Commission to connive in this, which is in effect what Article 22(3) does.

Nevertheless, both Article 9 and Article 22(3) raise somewhat difficult political issues, and it would be best not to be dogmatic about the boundaries between national and European competition policy. A useful compromise, very much within the spirit of subsidiarity, would be to allow some possibility for national authorities to be represented in MTF investigations for certain borderline Article 9 cases (for example, those in which it is unclear how much impact a concentration will have outside the main Member State concerned). Likewise, what are now Article 22(3) cases could be resolved by enabling Member States who presently lack competition legislation to establish small-scale competition agencies with the right to request technical assistance from either the MTF or from other Member States.

Finally, though, chief among the risks inherent in the uncoordinated national outcome is the tolerance of excessive market power. This could as easily imply use of merger control to stop efficient mergers threatening firms who have enjoyed their rents in the form of high costs or the quiet life, as the waving through of mergers that diminish competition. But either way, it implies that the procedures embodied in European merger control need to be adequately resistant to industry capture, to ensure that any gains from internationalization of merger control are not dissipated in increased tolerance of regulatory capture by those who benefit from market power. It is to an assessment of these procedures that we shall turn in Section 3. But first we should consider the most significant aspects of the criteria for assessment under which a European agency should operate.

2.3. Criteria for merger assessment

2.3.1. Competition and the efficiency defence

It is not, and could not be, the function of any merger control authority to decide whether a given merger is on balance a good thing. This is partly because the information required to reach such a judgment would be far more substantial than the authority could obtain for every case; more fundamentally because in a market economy there is a presumption that private agents should be free to pursue their own interests as they see fit unless this pursuit has adverse consequences for the interests of third parties. It is therefore to the external effects of a merger that the investigation process necessarily directs itself in the first instance, and if there are no adverse external effects a merger will and ought to be approved. This need not imply any naive optimism on the part of the authorities that mergers

[1] There is yet another, somewhat different rationale for Article 9, which is that on certain questions national authorities may have a major intrinsic informational advantage over those of the Community. If so there is certainly a case for their undertaking their own investigations, and perhaps in their interests being represented in some more formal way in the MTF's procedures than merely by membership of the Advisory Committee. But the case for their having a veto on such mergers depends on those cases not being characterized by large spillovers, which will not always be the case.

will always be beneficial to the parties undertaking them. There is by now a substantial literature (see Ravenscraft and Scherer (1987) for the USA, and Hughes (1992) for a survey of the UK evidence) casting serious doubt on the average long-term efficiency of mergers, and suggesting that either systematic over-optimism or (more probably) managerial motives of empire-building and the like are often responsible for promoting growth by acquisition rather than through market expansion.[1] While this certainly should restrain the authorities from any positive promotion of the merger process as such, it does not suggest that merger policy can or should in any way concern itself with insisting that firms do what is good for them.

This simple prescription becomes more difficult to apply, however, once the authorities judge that there are negative external effects (such as an increase in market power). For clearly these effects can be more or less serious, and if they are only mildly serious in a given case it may be questionable whether they should automatically override any positive private benefits that the merger may generate. It becomes inescapable to form some, if only tentative judgment about the significance of the private benefits in order to know whether and when they should be able to offset an adverse impact on market power.

The discussion in Section 1.3.2.2 above has therefore a relatively straightforward application to the questions of European merger control. It would be hard to make any kind of serious case that the question whether a proposed merger was harmful to competition was the only issue of importance from the point of view of social welfare; it would be hard likewise to deny that mergers which do harm competition may nevertheless have redeeming features. In order to decide whether a European merger control procedure should take explicit account of what is sometimes called the efficiency defence, what we must ask is not whether countervailing efficiency can sometimes make an otherwise anti-competitive merger worthwhile — to which the answer is obviously yes. Instead, the relevant question is whether the evident benefits of a procedure that acknowledges the efficiency defence outweigh its (perhaps less evident) costs. The benefits of an efficiency defence are obvious: they consist in the value of genuinely efficiency-enhancing mergers which could not otherwise be approved under the existing procedure since they harm competition too much. The costs of an efficiency defence consist principally in the harm done by genuinely undesirable mergers which are approved as a result of spurious claims about the magnitude of the efficiency gains to which they give rise.[2]

The important question is therefore how reliably a merger control agency might be able to assess the validity of claims about efficiency gains. There is one, somewhat purist view, which says never. It points to the adverse findings about the average efficiency of mergers and draws the inference that a merger control agency would never be able to tell *ex ante* which mergers would do better than the average. Therefore, according to this view, it should not even try, but should prevent all mergers which harm competition regardless of any arguments about countervailing benefits. On its own, however, this view has little merit. Even the negative findings of studies such as that of Ravenscraft and Scherer (1987) do not imply that all types of merger have the same *ex ante* prospects: some (principally conglomerate mergers between parties of very unequal size) do much worse than average while others (horizontal mergers between nearly equal parties) do substantially better. Furthermore, even a relatively cursory merger investigation will reveal more about the firms in question (such as whether there are prospects for rationalization of overhead costs) than is available in the large-scale data sets used for scholarly evaluation of mergers *ex post*. Even if an academic study based on a large data set could not predict *ex ante* which mergers would beat the average, it would not imply that the merger authorities with their different and more specific information could not do so.

But there is a more subtle argument for the conclusion that merger authorities cannot reliably assess evidence about efficiency gains. It appeals to what can be formally entitled incentive compatibility or more colloquially the Mandy Rice-Davies problem.[3] This is that the information required for the assessment is supplied by parties with a shared interest in exaggerating the benefits, and there is little scope

1 Such evidence may of course raise the possibility of a legitimate role for public regulation to protect the interests of shareholders that may be damaged by the managers who nominally act on their behalf. However such regulation if justified is not obviously the province of merger policy, but should rather be pursued with respect to the standing mechanisms of corporate governance to ensure that decisions regarding all corporate investments (not just mergers) adequately reflect the interests concerned.

2 There are other potential costs: first, any unpreventable predatory behaviour before the merger designed to increase the attractiveness of the merger outcome; and second, any increase in lobbying and rent-seeking to which the apparently more easily influenced procedure might give rise.

3 After a prostitute in the famous Profumo case in Britain in the 1960s who, on being told in court that the minister denied ever having met her, replied: 'Well he would say that, wouldn't he?'.

for third party corroboration.[1] Furthermore, the fact that information about efficiency benefits might be of very little value does not imply that its inclusion will make little difference to the outcome, for an agency prone to industry capture might well be able to use such information more effectively to escape scrutiny of the degree to which it was captured.[2]

This implies that two questions need to be answered satisfactorily before there are reasonable grounds for thinking that an explicit[3] efficiency defence will improve merger control. The first is whether the Commission can put in place procedures to compensate for the distorted nature of the information supplied to it by the parties to the merger. At the very least this must imply a very explicit burden of proof: for example, a statement that the efficiency defence will be considered only when, in the absence of convincing evidence to the contrary, the merger will be prohibited. Secondly, there should be some specialized investigation by an independent body of the empirical basis for any efficiency defence. One possible means for this might be the establishment of an efficiency audit unit within the Merger Task Force, with powers to conduct detailed internal enquiries within firms claiming efficiency gains — any firm not wishing to open its premises to such a unit would be presumed to have no efficiency gains worth claiming. It would be desirable for such a unit to operate independently of the MTF team investigating the merger, in order to ensure that its findings were not distorted by the desire to fit in with the conclusions of the team. And in order to give the unit the right incentive to gain a reputation for accuracy in its evaluations, it would be desirable for it to be enabled to offer its services on a consultancy basis to national authorities (and even, where appropriate, to private-sector firms provided conflicts of interest could be avoided).

The second relevant question is whether there are grounds for thinking the existing merger control procedure sufficiently robust to the danger of industry capture to be able to resist the temptation to use an efficiency defence as an excuse to rubber-stamp otherwise doubtful deals. We shall consider how robust the current EC procedure is in Section 3, first we examine what conclusions emerge from analysis of regulatory capture about other criteria for merger assessment.

2.3.2. Criteria for assessing competition

The question what criteria a merger control agency should use for assessing the external effects of a merger on competition raises mainly technical issues that are unrelated to problems of regulatory capture as such (but see Neven et al. (1993), Chapters 2 and 3, which deal in some detail with these issues). Nevertheless our discussion of questions of bargaining and reputation in Section 1.4 does have one very clear implication for these procedures: other things equal, it is important to have clear and transparent procedures that can not only be implemented but be seen to be implemented. This is because preventing mergers is potentially politically costly for the agency; firms (who enjoy a first-mover advantage in the bargaining process, since it is they who make the proposals that the agency must accept, modify or reject) may be tempted to exploit the agency's understandable preference for avoiding confrontation in order to induce it to accept anti-competitive proposals. The agency's sole defence against such manipulation is reliance on a reputation for performing its competition analysis objectively, and it can only acquire such a reputation if it commits itself to procedures sufficiently transparent to enable third parties to see whether it has in fact employed those procedures. If distortions of the analysis are invisible to third parties they are costless for the reputation of the agency; if they are costless for the agency they increase the temptation of the firms to manipulate the bargaining process. Paradoxically, therefore, an agency with a commitment to objective analysis has an interest in increasing its own potential for embarrassment by making its procedures as transparent as possible, in order to signal to firms its unwillingness to be manipulated.

What this means in detail is beyond the scope of this paper. But two themes emerge: first, that procedures that can be (at least approximately) replicated are preferable to those

1 The point is not that information about market shares, for example, can necessarily be corroborated by disinterested parties (since competitors, consumer organizations and so forth have their own incentives to exaggerate and misrepresent). The point is that incentives for distortion by these third parties may act in a different direction from those of the parties to the merger, and may therefore act as a check on any distortion in the information supplied by the latter.

2 A notorious example is the evaluation by the UK Monopolies and Mergers Commission of the merger in 1987 between British Airways and British Caledonian. This case was admitted to raise significant competition concerns. Not only was the sole evidence of countervailing efficiency gains that supplied by British Airways, but publication of this evidence (the magnitude of the gains as well as their source) was prevented by the Secretary of State, making its evaluation by outside observers impossible. The efficiency defence was accepted in spite of the fact that even the regulatory body concerned (the Civil Aviation Authority), which had examined the evidence, remained unconvinced by it.

3 There are already two respects in which efficiency considerations could be argued to have some implicit weight in the Community's existing procedures: one is a reference in the Regulation to technical and economic progress (albeit with the rider that it benefits consumers and is not an obstacle to competition); the other is the fact that arguments within the Commission about the merits or otherwise of particular controversial mergers frequently refer to efficiency benefits whether these are formally recognized or not. The latter was especially true of the de Havilland decision.

that cannot. So, for example, tests of product or geographic market definition that are backed by some quantitative survey evidence of the intentions of buyers are preferable to those that rely on the (albeit well-informed) hunches of case rapporteurs. Rough breakdowns of production costs into fixed, variable and sunk components are preferable to general statements about entry barriers being high or low. And secondly, it is desirable for the agency to publish as much of its reasoning in individual cases as possible (this has the additional advantage of enabling firms involved in future cases to anticipate the agency's procedure of analysis). How this kind of transparency might be achieved in the context of European merger control is a question we shall consider in more detail in Section 3.3. First, however, we consider some key aspects of the procedure as it stands.

3. The procedures of merger control

3.1. The Community and elsewhere: an international comparison

In this section we shall consider the steps by which mergers are assessed in the European Community, in the process comparing it with the equivalent steps in a number of other jurisdictions. Beginning with notification, continuing with investigation, and going on to decision and judicial review, we shall ask at each step: who is responsible? what are the factors determining the objectives of the regulators concerned? what are the constraints upon their decisions? and what are the risks of capture to which these factors particularly give rise?

Notification

Firms contemplating a merger in the European Community that may fall within the scope of the Regulation will typically discuss it confidentially with officials of the Merger Task Force (MTF), the body established within the Competition Directorate to undertake the day-to-day implementation of the Regulation. The purpose of pre-notification discussions is to speed up the evaluation of non-controversial cases, and also to minimize the costs of proceeding with a merger that is subsequently judged unacceptable. The latter rationale also underlies the requirement that mergers falling within the scope of the Regulation be notified to the MTF within a week of the triggering event (signing of contract, announcement of bid, etc.), and may not be put into effect for an extendable three-week period after notification.[1]

Table 2 compares, in a very simplified and schematic way, a number of aspects of the merger control procedure in the Community with those in Germany, the United Kingdom, France and the USA. One feature that will be noticed is that a single body is responsible for notification and investigation in the Community, as in Germany and France — but contrary to the situation in the USA, where two parallel bodies operate (albeit with coordination of their role in merger control). And in the UK, the body responsible for investigation (the MMC) is neither the party deciding whether an investigation is warranted (who is the Secretary of State for Trade and Industry) nor even the party advising the Secretary of State on that decision (who is the Director-General of Fair Trading). This unification of roles in the Community undoubtedly helps to enhance the efficiency of the procedure and its clarity to the parties concerned, since it allows those officials who undertake the preliminary discussions with the merging parties to speak with some authority about the way in which the investigating agency will approach the case. However, it also carries certain risks, namely that officials will commit themselves implicitly in pre-notification discussions (and therefore without adequate investigation) to approving certain kinds of transaction.[2] It is notable that a number of recent EC mergers that either involved high-market shares or raised sufficiently serious competition issues to warrant the negotiation of remedies were nevertheless approved within the one-month preliminary investigation period (see Neven et al. (1993), Chapter 3). The

1 Pre-notification usually therefore minimizes the cost of merger control to firms, but it may also raise the credibility of the procedure by ensuring that the costs are ones firms could reasonably be expected to bear. By way of contrast, the purchase of DFK Gas AB by AGA AB, a Swedish carbonic gas manufacturer, in 1987, was not notified to the Swedish authorities since Sweden has no pre-merger notification requirement. By the time the competition ombudsman sought to prevent the merger, which gave the new firm a 97% share of the Swedish carbonic acid market, the Market Court judged that integration of the firms' operations had proceeded so far that separating the operations would have been extremely costly, so the merger was allowed to proceed (see Boner and Krueger (1991), p. 70).

2 Officials from the MTF have no explicit power of commitment, of course. Nevertheless, since the purpose of pre-notification discussions is partly to signal to firms whether or not their transactions are likely to prove problematic, the risk is that officials who have (in good faith) encouraged the notification of a transaction that subsequently turns out to be potentially problematic, may be tempted to pursue the investigation less vigorously than they should, in order to avoid making their earlier encouragement appear incompetent. There is an analogy here with well known incentive problems in banking regulation, where regulators who have failed to spot solvency problems at a particular bank may be tempted subsequently to cover up the fact in order to avoid drawing attention to their earlier failure to discover the difficulties. (I am grateful to Jean Tirole for this point.)

Table 2

Merger control procedures in various jurisdictions

Merger jurisdiction	Notification	Notification requirement	Investigation	Decision	Decision criteria	Efficiency defence	Advice	Head of investigating agency	Publication of guidelines, recommendations	Review or appeal
European Community	Competition Directorate (Merger Task Force)	Pre-merger	Competition Directorate (Merger Task Force)	European Commission	Dominance	Not explicit	Advisory Committee on Concentrations	Politician	Brief decisions; annual report	European Court of Justice, Court of First Instance
Germany	Bundeskartellamt	Pre-merger for largest, post-merger for others	Bundeskartellamt	Bundeskartellamt s.t. overrule by Minister for Economics	Market power	No for Bundeskartellamt, yes for Minister for Economics	Monopolkommission	Civil servant	Biennial report	Berlin Court of Appeals/ Supreme Court
United Kingdom	Director-General of Fair Trading	Pre-merger voluntary, post-merger for others	Monopolies and Mergers Commission	Secretary of State for Trade and Industry	Public interest, with emphasis on market power	Yes		Civil servant	Detailed case reports, policy document in 1991	None
France	Ministry of Economic Affairs	Pre-merger voluntary	Conseil de la concurrence	Ministry of Economic Affairs	Market power	Yes	Conseil de la concurrence	Administrative law judge	Brief recommendations, annual report	Administrative Supreme Court (Conseil d'État)
United States	Federal Trade Commission, Department of Justice	Pre-merger for largest	Federal Trade Commission Department of Justice	Federal District Courts	Market power	Yes, though not very influential in practice		Politician (DoJ), politically balanced group of Commissioners (FTC)	Merger guidelines	Appeal Courts/ Supreme Court

The column headed 'decision criteria' has sought to distinguish between jurisdictions that base decisions primarily on competition criteria according to whether these are mainly single-firm based ('dominance') or take multi-firm interaction into account ('market power').

current procedure places greater emphasis on efficiency and predictability from the point of view of the parties than on transparency from the point of view of the general public.

Investigation

So what are the incentives and constraints at work in the investigation procedure? As Table 2 makes clear, the investigating agency in the Community is more directly under political control than in the other jurisdictions, except the US Department of Justice which is under the direct control of a cabinet minister, the Attorney-General. European Commissioners are not, however, like national politicians — they are, in particular, required to forswear national allegiances on joining the Commission. While it would be naive to think that this removes all risk of national capture it does nevertheless point to the fact that Commissioners have a significant stake in establishing a reputation for transcending their political origins. However, this does not turn Commissioners into civil servants, and there is little doubt that political influence (in particular, a general preference for relatively restrictive or relatively permissive approaches to merger control) can be more easily exercised through the control structure of the European Commission than in the other agencies (again with the significant exception of the US Department of Justice). This conclusion is strengthened by noting that the Advisory Committee on Concentrations, which consists of representatives of the Member States, meets with the Commission's staff during the investigation and before any publication of the results of the investigation. There are in addition numerous informal contacts with national administrations; there are the inter-service meetings at which the MTF consult with staff from other parts of the Commission, many of whom have already been vigorously lobbied by different interested parties (see Neven et al. (1993), Chapter 4). MTF staff therefore feel the impact of political pressures surrounding the cases under investigation at a relatively early stage in the procedure. They are also aware that political pressure is exerted liberally at points above them in the Commission's hierarchy — according to one MTF rapporteur: 'I sometimes get only 10 minutes to present the outlines of the case analysis to the Commissioner; and I know that after I've done so the firms will get half an hour to talk to him'.

It is only fair to recognize that these political pressures are, nevertheless, somewhat muted compared to what they might be if decisions on merger control were taken by the European Council. Competition policy is — unlike many other areas — specifically delegated to the Commission, and Regulation 17 of 1962 further delegates to the Commission substantial powers (of investigation, prosecution and the definition of liability) to enable it to implement such policy.

The distinction between political and administrative mechanisms is in any case a matter of degree. No merger control procedure lacks mechanisms for the exertion of political influence, and the presence of such mechanisms in the Community is neither surprising nor in itself a cause for concern. But there are two features of the way in which such influence may be exerted that are neither necessary nor desirable, and both arise from the procedure's comparative lack of transparency. One is that the political influence can easily be exerted before an investigation into the facts of the case has proceeded very far,[1] and certainly before any publication of findings. A preliminary report is prepared by the MTF before the meeting of the Advisory Committee, but this report is not published. The decision that is eventually published (besides being much shorter than the reports of, for example, the UK's Monopolies and Mergers Commission), is supported by reasoning that may well have been substantially redrafted since the basic facts of the case were established, and will be constrained by the need to justify a decision of the Commission as a whole. It will typically have been redrafted in the light not only of technical commentaries but of an awareness of the political pressures on the decision. Not only will this tend to distort the actual analysis of the competition aspects of the case, it may also tend to obscure which kinds of political pressures were actually most influential in determining the outcome.[2] The aim of greater transparency, by contrast, is not to banish the influence of political pressures, but enable those pressures to be visible without disguise.

The second consequence of the nature of the political accountability of the MTF is that it facilitates the exertion of pressure on a case-by-case basis. It is common — and desirable — for merger control agencies to be responsive to swings in general policy towards mergers. For instance, the 1984 Tebbit guidelines indicated that references to the UK Monopolies and Mergers Commission would be made more consistently on competition grounds than previously; while these guidelines had no power to bind the MMC itself, they were a clear and transparent indication of political preferences for giving emphasis to certain of the MMC's criteria over others. Such pressure is very different from pressure to approve or block particular mergers. Pressure of the latter kind can be and is exerted in all jurisdictions (for instance, the decision by the German Economics Minister to overturn the decision of the BKA blocking the Daimler-Benz/MBB merger in 1989), but it takes place more visibly in some than in others.

Transparency is assisted by the publication of details of the analysis and recommendations of an investigating agency without the constraint of its having to support the decisions

[1] To some extent, direct political accountability of the agency may substitute for more subterranean channels of influence. For instance, one official of the US Department of Justice interviewed by us was asked whether he had faced attempts to pressurize him directly in the investigation of a case. He could recall only one such intervention (by a Senator from the same party as the President then in office seeking lenient treatment of the firm concerned) which he had been able without too much difficulty to ignore. But he added that most Senators would have found it unnecessary to seek to exert pressure on officials of the Justice Department when they could do so directly via their political representative, the Attorney-General, especially when the kind of pressure they might exert was in a direction congenial to that individual's political views. Consequently, an agency not headed by a politician might find itself open to more frequent attempts to pressurize its officials in order to influence investigations before their results become public. The seriousness of this risk would depend on the incentives for individual officials to resist covert pressure of this kind (including the strength of the professional ethic in the bureaucracy).

[2] A number of participants at inter-service meetings have told us that it is not uncommon for efficiency gains to be urged in favour of particular transactions even though their consideration is not a formal part of the Regulation. Whether such arguments are influential is hard to evaluate; what is certain is that, if they are, this fact will not be evident from the Commission's published decision. And claims about the magnitude of such gains will not have been subjected to the kind of rigorous empirical examination that an explicit efficiency defence might require.

of the political authorities. Whether the agency is headed by a politician or a civil servant is not nearly so significant on its own. For instance, the Conseil de la concurrence, though notionally independent of the French Economics Ministry since its foundation in 1986, is subject to much more activist political review than the MMC or (especially) the BKA (see Boner and Krueger (1991)). Likewise the fact that the MMC is headed by a civil servant and makes only recommendations, not decisions, has not prevented it from coming under some political pressure — but the fact that it publishes very detailed reports makes such pressure more visible, as a glance at the report on the British Airways/British Caledonian merger will confirm[1] (see footnote 2 on p. 95). Furthermore, what makes the MMC most vulnerable to pressure is not its procedures, which are comparatively transparent, but the vagueness of its criteria (in particular the broad range of factors it is entitled to consider under the public interest heading).[2]

The problem of vagueness of criteria is not resolved, however, simply by restricting criteria to competition rather than more broadly public interest concerns. The explicit rationale of the US merger guidelines is that the notion whether a merger harms competition is too vague by itself either to be reasonably predictable by firms or to ensure that the agency follows a consistent (and credible) procedure. The same reasoning surely applies to European circumstances: guidelines, detailing a check-list of procedures to be followed, do not prevent an agency from departing from them, but may at least provide some pressure to ensure that such departures are made for defensible reasons rather than capriciously.

Decision

Although the analysis of a merger case is undertaken by the Community's Competition Directorate (and specifically by its Merger Task Force), the decision regarding a particular case is taken by the Commission as a whole. Consequently, in any controversial case the Competition Commissioner must make a careful assessment of the extent to which he can carry support within the Commission for his preferred decision. On competition matters the views of the Competition Commissioner naturally have great weight, but it is not absolute. The nature of the political process by which a judgment by the Merger Task Force on the intrinsic merits of a case is transmuted into a political compromise is unfortunately very opaque. Good press discussion of particular cases can help, but by its nature it tends to be limited to reporting the more obvious instances of disagreements, such as when a Commissioner is overruled by the rest of the Commission. However, such cases will always be rare, and give little insight as to whether the eventual decision is one that the Competition Commissioner (let alone the MTF) would have preferred. Commissioners wish (like all politicians) to gain a reputation for success in persuading their colleagues. They will therefore minimize instances of overt disagreement, usually by adapting their case to be congenial to the perceived views of the majority on the Commission instead of forcing an unmodified recommendation to a vote there is a serious risk of losing. This is neither surprising nor undesirable, nor is it undesirable that the investigation of a merger should be subject to subsequent political review. What is unfortunate is that, given the fogginess of the boundary between the investigation and the subsequent review, the nature of the political negotiation risks distorting the character of the investigation.[3] And the distortion becomes all the more important the earlier in the procedure the parties begin explicit or implicit negotiations, a fact that has implications for the extent to which the Commission should be empowered to accept legally binding undertakings in first-stage investigations.

Judicial review

Judicial review constitutes a much more transparent procedure, but unfortunately this is due partly to its very slow and cumbersome nature. An appeal brought by a Member State to the European Court of Justice (ECJ) is likely to take up to two years, and although private parties can bring cases more rapidly to the Court of First Instance, these face the possibility of further appeal to the ECJ. The consequence has been that both the Commission and the parties concerned have been extremely anxious to avoid judicial review, which would jeopardize the very speed and efficiency which has been one of the hallmarks of the Merger Regulation's first two years. In the Commission's case there has been the additional important need to establish legitimacy for its procedures, which would have been difficult to do if significant numbers of its early decisions had been subject to challenge by the courts. However, the wish to avoid judicial

1 For instance, while the responsible politician was able to prevent publication of details of the alleged efficiency gains (on grounds of commercial confidentiality) he would have found it much harder, in a full and detailed report of this kind, to justify preventing publication of the CAA's opinion that BA's resort to the efficiency defence was unconvincing.

2 Another way to express this is that what the MMC most needs is *ex ante* transparency. Neven et al. (1993, pp. 174 ff.) discuss in more detail the distinction between this and what they call *ex post* and procedural transparency.

3 In particular, Commissioners who have previously been ministers in their Member States may think of an investigating agency as essentially in the business of providing advice to political decision-makers, and may therefore view the avoidance of political embarrassment as at least as important as the provision of objective analysis.

review is not neutral in its effects on the investigation and decision procedure, but will tend to distort decision-making in favour of those interest groups that are most likely to resort to the courts if the decision is not to their liking. In an uncontested merger the parties who gain from the deal (in particular, the merging firms) are likely to be better organized and informed, and consequently more likely to seek judicial review, than those who might lose (such as consumers). Consequently the pressures to avoid judicial review will tend to bias the procedure in favour of approval in such cases; this applies less to contested mergers, where the management of the acquired firm face fewer organizational obstacles, and where the threat of judicial review can even be thought of as a kind of poison pill.

To an extent, the Commission can reduce the risk of review by negotiating remedies with the parties concerned; it is hard for a party to a merger convincingly to bring a legal appeal if it has already indicated willingness to agree to proposed remedies. Once again, though, this is not neutral in its effects: it encourages resort to cosmetic remedies, or to ones that rely on excessive optimism about the future development of competition, or to ones that involve the Commission in inappropriately detailed positive intervention in the structure of firms and of markets (see Neven et al. (1993), Chapter 3). It may particularly encourage such remedies in cases that involve the Commission breaking new ground, or otherwise making general policy in a merger case. Such criticisms were levied at the Commission in the 1992 Nestlé/Perrier case, which involved the first explicit use of the concept of collective dominance. It has been suggested that the Commission was particularly keen to avoid judicial challenge by the firms to this innovative decision; if there is any truth in this, it is ironic that the decision has indeed been challenged, only by a party (namely the Perrier workforce) opposed to rather than supportive of the deal.

Furthermore, it is in the nature of many remedies that they are negotiated very much at the last minute and at the level of the Commission rather than at the level where the analysis is performed (in the words of one MTF rapporteur, 'we often learn about the remedies after the handshaking has taken place'). They do not receive, therefore, the kind of economic analysis that they need: the analysis that appears in published decisions has often been written in the awareness of a *fait accompli*. And in the absence of objective analysis it is hard to see how remedies can help being *ad hoc*.

Paradoxically, therefore, the most transparent component of the Community's merger control procedure (namely judicial review) imposes sufficient costs on the parties concerned that, in a quite reasonable wish to avoid it, they may in practice resort to procedures that carry a risk of increasing the opacity and the distortions in the process as a whole. This suggests a need to seek less costly ways of ensuring transparency.

3.2. Strengths and weaknesses of the Community's procedure

The discussion so far has suggested the following important strengths in the Community's merger control procedure by comparison with that of other jurisdictions:

(i) It is fast, with the great majority of cases decided within a month, and the remainder within four months.

(ii) It is flexible, with the pre-notification discussions in particular enabling the Task Force to waive unnecessary information requirements.

(iii) The fact that a single body is responsible for notification and investigation makes it possible for firms to be better informed before they commit themselves about the kind of investigation they will face.

(iv) It has removed some pre-existing ambiguities about the boundaries between Community and national jurisdiction with its one-stop shop, though ambiguities about the treatment of joint ventures have been very significant.

The main weakness of the procedure, however, is its lack of transparency, particularly for an agency that is under more direct political control than most. This is evident both in the fact that there is no report of the analysis of individual cases that is written independently of the need to justify the eventual decision, and in the somewhat less systematic character of the criteria for analysis than those of (for example) the US Department of Justice (see Neven et al. (1993), Chapter 3). It applies especially to negotiated remedies, which often receive no systematic analysis at all prior to being agreed.

The comparative precision of the Commission's decision criteria, as embodied in the emphasis on competition criteria in the Regulation, is not enough of an advantage to compensate. This is particularly so because, in the absence of transparency, it is not clear how free the decision-making process can continue to be of covert appeal to non-competition criteria; what is certain is that such criteria are not given systematic examination.

This lack of transparency may well lead to a greater degree of capture in the future than it has done up to now, as the work of the MTF becomes more routine and its presence on the European scene less of a novelty (and as the various interest groups become more skilful at applying effective pressure). But is it possible to say anything about the kind of capture which might result?

A number of considerations suggest that future distortions of the merger control procedure because of regulatory capture are likely to be in the direction of excessive tolerance of market power, especially by firms with a strong base of national or regional political influence (a combination of national and industry capture, in other words). To some extent this is because of the pressures that were noted in Section 2 and which an EC-based procedure may be only partly successful at offsetting. It is partly also because political influence in the Community will continue to coalesce around national interest groups to a significant extent for the foreseeable future.[1] To some extent the Commission as a transnational body can help to overcome these tendencies. But even so the Commission is not organized exactly as a transnational civil service: certain posts are by convention reserved for nationals of certain Member States, for instance. Some of those who work in the Commission (and a greater number in the MTF than elsewhere, given the necessary speed with which it was established) are appointed for temporary periods, either as *agents temporaires* or as national civil servants on secondment to the Community, often on terms more favourable than their appointments in their home countries. It may be difficult in such circumstances for the officials concerned to build up the continuity and sense of collective professional identification that may be needed to resist the national and sectional pressures that surround an institution like the Commission.

A degree of capture by national interests need not imply industry capture (indeed it is compatible with excessive controls upon industry by governments prone to blocking mergers on nationalistic grounds). But in the present circumstances national pressures are more likely to lead to industry capture than the reverse. This is partly because in most contexts firms are more effective at lobbying national governments than are other interest groups. It is also because the speed and lack of transparency of European procedures, plus the reluctance of the Commission to provoke resort to judicial review, encourage the strategic manipulation of the procedure by well-informed firms, as was noted above. Firms know that expressing a willingness to compromise on some aspects of a doubtful merger invites a degree of compromise from the Commission in turn (this is especially so when the arguments take place to a considerable extent informally prior to notification). But the first move in this bargaining game is not made by the Commission — it is made by the firms. The knowledge that concessions from the Commission can be bought by concessions from firms therefore invites firms to make initial proposals even more anti-competitive than they need be in order to leave scope for concessions. The bargaining process is one that encourages a certain extremism in opening proposals, in other words.[2] At the very least it diminishes the pressure on firms to diminish any anti-competitive impact of a transaction before they come to the Commission. Market conditions may not always permit this kind of strategic manipulation, since they may constrain feasible deals quite tightly. But where they do leave room for flexibility, well advised firms are likely in future to exploit the bargaining procedure to the full, in a way considerably facilitated by the lack of transparency of that procedure.

Most of all, the procedure leaves very little scope for the exercise of any countervailing power to that of the Commission itself, subject as it is to pressure from the parties to the transaction. Third parties have very little time in which to make representations (and no time at all where negotiated remedies are concerned). Competitors often have little interest in doing so since they may be beneficiaries of market power (and where their interests are potentially more directly affected — namely in the imposition of remedies — they have no opportunity to complain). Buyers may take an interest, but only in cases where they are well organized and prompt. In fact, in some respects the most significant countervailing power to the Commission comes from Member States (a fact which may explain the reluctance of some to cede more power by downward revision of the turnover thresholds); yet it was the very fact that Member States' interests may lead to distortion of the merger control procedure that provided the most coherent rationale for the European Merger Regulation in the first place. What this highlights therefore is that, given the opacity of current procedures, some more credible countervailing power is needed. Member States at present provide what little of this there is, but it is not enough, and it comes from the wrong source.

Some of the risks we have discussed are hard to avoid in any procedure that places a premium — as the Community rightly does — on speed and responsiveness to firms' con-

[1] This will not necessarily be much diminished by any future shift in the balance of political power away from the Commission and Council of Ministers and towards the European Parliament, since voting blocs in the Parliament are likely to be at least as much influenced by national and regional divisions as is the distribution of power within the Commission itself (which matters more than the Council as far as competition policy is concerned). Only the formation of genuinely pan-European political parties is likely to change this, and linguistic and cultural factors make this a distant prospect.

[2] There is an analogy here with arbitration procedures in industrial relations, where it is well known that some apparently unreasonable procedures (such as final-offer arbitration) encourage moderation in the parties' demands. More apparently reasonable procedures (such as splitting the difference) encourage unreasonable claims.

cerns.[1] However, there are a number of kinds of general reform that might help to reduce these risks. These are the subject of Section 3.3.

3.3. Some options for change

The discussion of transparency has repeatedly pointed to some of the disadvantages inherent in the fact that the different stages of the Community merger control procedure are blurred into each other in a way that is difficult to distinguish from the outside. Yet, clearly, speed and flexibility may partly be compromised by separating out all the stages of the procedure, and separating these in turn from the normal processes of political compromise within the Commission itself. At what stages in the process, therefore, is separation most important, and how can it best be achieved?

Graph 1 shows a very schematic outline of six stages of the merger control procedure: notification, investigation, negotiation, decision, political review and judicial review. This is not a chronological but a logical division since in practice a number of the stages (investigation and negotiation, for example) overlap with each other. At present the Community's procedures effectively assign all the first five stages to one body (the European Commission). It is true that at least the first two are carried out by a notionally separate body (namely the Merger Task Force), but for the reasons already discussed this acts more as a support unit to the Commission than as a genuinely and visibly separate agency. The fourth and fifth stages (namely decision and political review) are not distinct in the Community's procedures since the Council has no power to overturn the Commission's decisions.

Modifications to the procedure to meet some of the concerns about transparency can be divided into two main categories: those that can be undertaken within existing institutional arrangements and those that would require changes to these arrangements. Changes compatible within existing arrangements are basically fourfold. First, changes in reporting procedures. Draft decisions could be published. Similarly, the opinion of the Advisory Committee on Concentrations could be published immediately after the Committee has met, and before the case is brought in front of the Commission. And, most importantly, proposed remedies could be given a proper evaluation by the Task Force. If the proposals appear early enough in the process, an evaluation can be included in the draft decision; otherwise there is a strong case for requiring a minimum breathing-space after the proposal of remedies, in order to invite third party comments, to give the Task Force time to undertake a proper evaluation, and to ensure that the Commission itself has time to reflect without being bounced into a decision. The present negotiation of remedies is one of the most opaque parts of the whole procedure, opaque in some cases even for the case rapporteurs. At the same time, remedies may sometimes affect significantly the competitors of the merging firms. It would seem important to let these competitors have the opportunity to voice their opinion and to give them sufficient time to do so.

Secondly, there is a case for placing the burden of proof on firms whose proposals fail the initial screening (Phase 1). This provides the firms with a strong incentive to reveal necessary information. This incentive could be further enhanced by 'stopping the clock' for investigations during the time it takes the parties to respond to information requests. Currently such suspension occurs only exceptionally, when the Commission has to request information by decision or to order an investigation by decision.

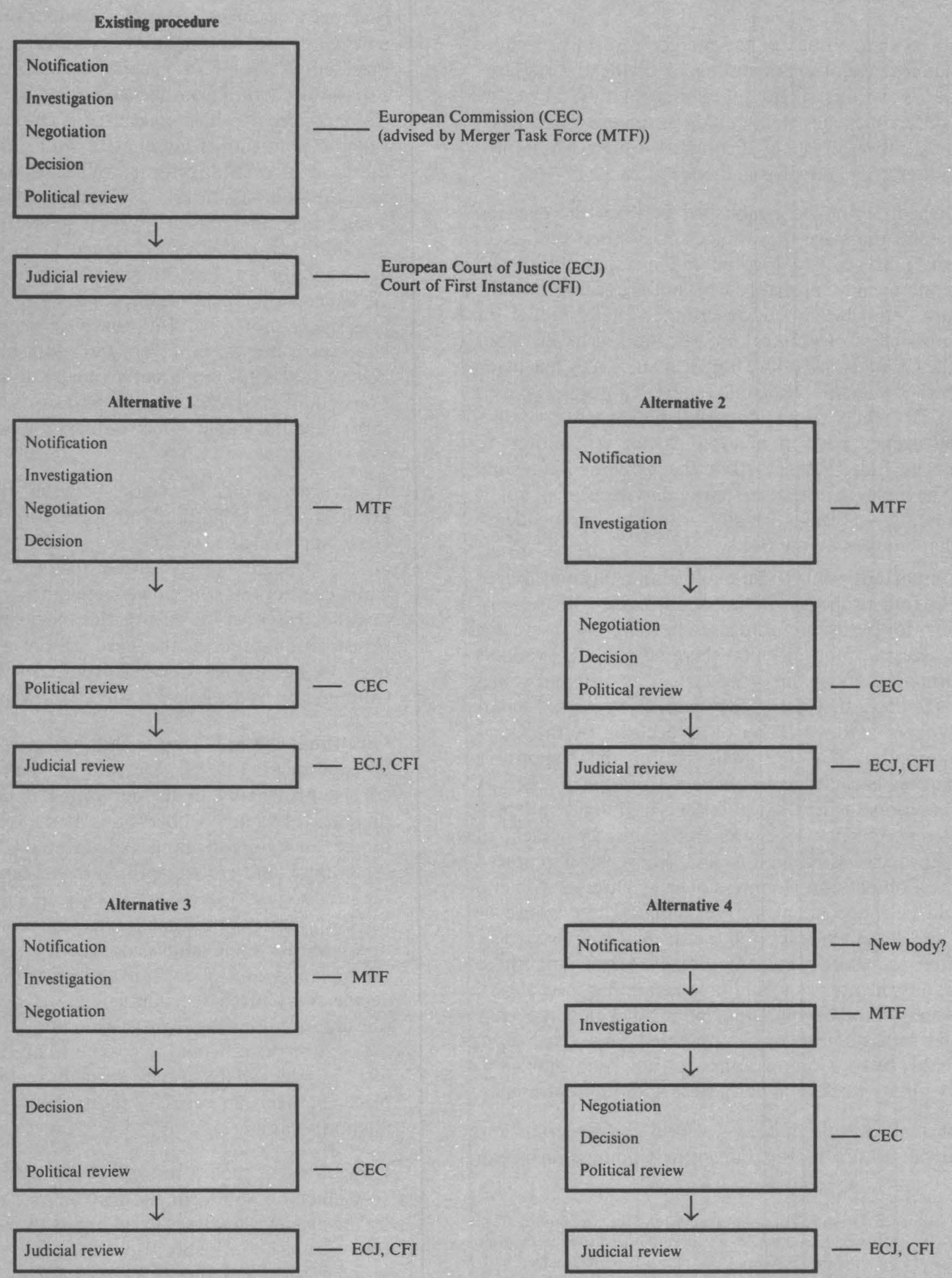
Thirdly, the publication of guidelines would greatly increase the transparency of the procedure, both in the sense of reducing the uncertainty faced by firms and in making it easier for the Commission to send a signal of its unwillingness to be manipulated during the bargaining procedure that accompanies any difficult deal.

Fourthly, cases which involve negotiated remedies (that is, anything which depends upon an undertaking by the firm as to its future behaviour) should automatically proceed to the second stage of investigation. This need not prevent the MTF from reporting well within its deadline (or even within the deadline for the first stage if the case is sufficiently urgent). But it would ensure that the MTF had adequate powers to require information sufficiently detailed to enable it to assess the case properly.

These changes are all compatible with the existing institutional framework of European merger control, though they would help to make more transparent the distinction between the various stages of the procedure. But for that very reason, it is important not to exaggerate the benefits to which they would give rise. For example, without a degree of separation between the agency undertaking the analysis and that responsible for the decision, there will still be a tendency for the case analysis to be written to justify de-

1 Nevertheless, calculations in Neven et al. (1993, Chapter 2) indicate that a gain of an extra month or two in a merger investigation is not worth having at the price of increasing the risk of a wrong decision by more than a few percentage points. It is quite likely that in discussions with the Commission, firms exaggerate the costs to themselves of delaying a merger (e.g. by proceeding a second stage investigation). It would be in their interests to do so, particularly if they believe that an over-hasty investigation is likely to increase the overall probability of approval.

GRAPH 1: **Division of responsibility for stages of procedure**



cisions, the outline of which can already be foreseen. Publication of draft decisions can reduce this tendency, but not by as much as would be desirable.

More radical innovations in the merger control procedure might therefore involve attempting to divide the responsibility for its various stages more thoroughly and visibly between different bodies. This could in principle be achieved in a variety of ways. Let us distinguish four possible proposals, and examine the pros and cons of each:

(i) A division could be established between the decision stage and the stage of political review (between stages 4 and 5). Stages 1 to 4 would be the responsibility of a separate agency, probably working according to quite tightly defined competition criteria, and to allow for the possibility of political modification of its decisions by the Commission only after such an agency has made its decision and published its report. This appears to be what advocates of an independent European competition agency have in mind. It is not tantamount to complete independence since the Commission would still be able to overturn particular decisions, but it represents — at least formally — as much independence as that enjoyed by the BKA.[1]

An important point to be made about this and indeed all the four proposals is that, for a division of responsibilities for the different stages to be more than cosmetic, it is necessary not only that there be publicly available information about the procedure at its different stages (for instance, that the agency publish its report separately from any overriding of its decision by the Commission), but that the goals set for the responsible agency at each stage be distinct from each other. A competition agency that published notionally independent reports but which was still a sub-department of the European Commission and whose head reported to the Competition Commissioner or Director-General would be independent only in name. There would be still the same tendency for the agency's reports to be written to justify decisions already taken; and those decisions themselves would be taken under the political pressures of the Commission. So an independent agency would need its head to be appointed for a fixed term, probably by the Commission as a whole, and enabled to carry out its work on a daily basis without interference.

How realistic this option is within the structure and political culture of the European Commission is not straightforward to assess. It is not clear whether a structure similar to that of the Bundeskartellamt could be easily implemented within the Commission; the BKA is actually organized around a number of independent units whose decisions cannot be overturned even by the President of the BKA. Such an organization would be a major departure from the traditions and habits of the Commission, in which consensus is emphasized and in which a politician is nominated, with much power, as the head of each directorate. Whether in the medium term the Commission could be persuaded to accept such a reform is hard for us to say; it seems improbable in the short term, if only because it is hard to imagine agreement between the Member States about how such an agency should be set up and what its criteria of assessment should be. We believe such a reform would have some merits; however, and more practically, we believe that a less apparently radical division of functions could go a very long way towards achieving the same benefits, and at somewhat less political cost.

(ii) A division could be made between the stages of notification/investigation and negotiation/decision (between stages 2 and 3). In other words, there might be an independent agency responsible for investigation, while decision-making power remained with the Commission. In order to ensure the independence of the investigation process, the head of the agency would need to be appointed on a fixed-term basis by the Commission as a whole.

Given that the MTF under this system would have no decision-making power, the value of the reform would consist principally in its publishing detailed reports, unamended by any deliberations by the Advisory Committee on Concentrations (which could be published separately), and consequently relatively undistorted by the need to justify decisions already taken. Whether the MTF's reports should make precise recommendations or lay out for the Commission a series of options, with the pros and cons of each, is a more difficult matter to decide. Very precise recommendations, coupled with a presumption that the Commission would not normally act against them, would make the MTF de facto more like an independent agency; a menu of options would place the decision capacity more clearly in the Commission's hands.

How effective such a reform would be would depend very much on how strongly the Commission felt bound by the agency's analyses in taking its decisions. That in turn would be influenced by the agency's own ability to establish a reputation for persuasive and objective analysis, as well as on the kind of publicity received

[1] It is arguable that the different political culture of the Community from that of Germany would lead the Commission to use its right to overrule much more than is done in Germany. 'The only way to make a Eurokartellamt work would be to put it in Berlin', was how one Commission official expressed it to us.

when this analysis was ignored. Nor is it inconceivable that some of those interests in the Community at present opposed to an explicit efficiency defence in the procedure might be reassured that the presence of an independent source of competition analysis would at least ensure that any claims about efficiency gains received a full and objective evaluation, instead of operating on the basis of hunch and suggestion.

(iii) A third possibility is that investigation could still be kept separate from decision, but negotiation could be made the responsibility of the investigating agency rather the decision-making agency. The main purpose of such a proposal would be to take account of concerns that separating the negotiation from the investigation stages would slow down the process of agreeing and evaluating remedies.

However, it is not clear that such a proposal would be very practical, as the agency would be seriously limited in the conviction with which it could enter into negotiations if it were truly independent of the decision-making body. And one of the persistent themes in our discussions so far has been the potential distortion to the objectivity of competition analysis induced by the nature of the negotiation process.

Nor is it very clear how much delay the separation of investigation from negotiation and decision-making would in fact impose upon the process of negotiating remedies. Firms would negotiate with the Commission; all that would be required would be for the MTF to have prepared a report on the proposed remedies before the Commission reached its decision. There might be a small delay, but a delay well worth accepting for the benefit of significantly improved transactions. One thing it would make more difficult would be for the Commission to succumb to the temptation of accepting a remedy first and performing the analysis later — but that is hardly the most damning objection imaginable.

(iv) Notification could be separated from investigation (stage 1 from stage 2). We have discussed the possible risks that might arise from implicit undertakings being made during the pre-notification process. However, it has also become clear that the benefits of pre-notification discussion with the same agency that will perform the analysis are very substantial (both in increasing speed and in avoiding the costs of firms misunderstanding their chances of approval). The risks in pre-notification discussion would seem to arise chiefly through an insufficiently clear separation of the investigation from the decision-making bodies; if that can be achieved, the benefits of a unified notification and investigation procedure seem comfortably to outweigh the costs.

Overall, therefore, of the four different ways discussed here of increasing the degree of separation between different components of the European merger control procedure to assist transparency, the most persuasive seems to be to separate the notification/investigation procedures from the remaining ones, though there are some arguments in favour of the other changes.

Neven et al. (1993) discuss a number of other changes to the terms of the Regulation, and the methods of analysis used by the Commission in assessing particular mergers. Space forbids discussion of these proposals here, and in any case many of them are unrelated to issues of regulatory capture. However, two points in particular are relevant to the present discussion. First, the question whether or not the terms of the Regulation should be broadened to include an explicit efficiency defence should not be answered simply according to whether or not efficiencies are thought to be frequently an important ingredient of merger proposals. An efficiency defence can indeed be exploited to gain approval for dubious merger proposals (a concern that has evidently motivated the opposition of some Member States to the inclusion of an explicit efficiency defence in the Regulation). However, it can also, if properly implemented, be used to scrutinize rigorously claims about efficiencies that under the current system receive no scrutiny but may nevertheless be influential in determining Commissioners' attitudes to a particular case. Inclusion of an efficiency defence may or may not imply a relaxation of competition policy; everything depends upon how it is implemented, and those Member States that are more sceptical of industrial policy may have as much to gain from an efficiency defence as those who are less so. All Member States would have something to gain from a procedure that ensured efficiency gains were given a weight in decisions when (and only when) they were demonstrably important.

The second point made by Neven et al. that is of relevance here is that, in comparison with some of these changes in procedure, changes in the turnover thresholds determining which mergers fall under the Commission's jurisdiction are a matter of considerably less importance. The arguments for lowering the thresholds are rather finely balanced; by contrast, the case for procedural reform has a greater weight of argument on its side.

All of these proposals for procedural reform have some rationale in the considerations that have emerged from our review of the literature. To some extent the components come as a package, in the sense that — as the discussion of general principles above reminded us — piecemeal implementation of reforms in organizational design can sometimes worsen the very phenomena of regulatory capture they are designed to alleviate. But it should be stressed that the precise weight that should be accorded to each component is a matter of judgment. And for such judgment no general principles can be an adequate substitute.

4. Concluding remarks

This article has not, except incidentally, discussed the actual cases handled by the European Commission during the slightly more than two years of operation of the Merger Regulation. Instead it has focused on whether the procedures now in place might, irrespective of their results so far, be expected to lead to forms of regulatory capture in the future that could be prevented by appropriate reforms. Nevertheless, it would be inappropriate to end without acknowledging that the MTF has managed within this period to surprise and impress the business community with the speed and informality of its procedures, which have contributed strikingly towards reducing the costs to firms of the necessary process of merger control. However, it should not come as a surprise if, after an initial honeymoon period, it becomes harder to please a business community whose expectations of what can be achieved by a merger control procedure have been so impressively raised. One of the lessons of the study of regulatory capture is that merger regulation (like all regulation) is a process of adjudicating between conflicting interest group pressures. It would therefore be unrealistic to expect any effective system of regulation to continue to earn the admiration of any single interest group, and disturbing if praise for its virtues were to come consistently from a single source. This article has sought to identify a number of potential biases in the existing procedure that may be of importance in the future, and to propose measures that can diminish their impact.

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The relevant antitrust market

L. Sleuwaegen

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1. Introduction

The definition of a relevant market is of utmost importance for effective enforcement of antitrust laws. Unfortunately, and in spite of good theoretical principles, economists feel quite insecure when defining where a specific market starts and where it ends. The lack of uncontested and solid operational procedures to delineate antitrust markets may help to explain why experienced practitioners, for example, in the US and EC merger control, differ to some extent in their philosophy and quite considerably in their practical procedures for determining a relevant market.

The present paper contributes to resolving these differences by proposing an explicit theoretical framework and by relating this framework to the measures used by practitioners. The same theoretical model will define the two fundamental dimensions of a relevant antitrust market: product scope and geographical scope. Product scope defines the goods and services that are grouped together, while geographical scope defines the relevant geographical area in which firms compete for selling their products and services. The theoretical framework proposed in the paper makes extensive use of recent theoretical research concerning antitrust market delineation in the USA.

2. An economic versus an antitrust market

An economic market is most commonly defined as that area and set of products within which prices are linked to one another by supply- or demand-side arbitrage and in which those prices can be treated independently of prices of goods not in the market (see Scheffman and Spiller (1987), p. 123).

An antitrust market is defined differently. For instance, in merger control of a group of products in a certain geographical area, the basic question is whether the proposed merger will facilitate the exercise of substantial monopoly power by the merging firms or some larger group of firms. By monopoly power, alternatively identified as market power, is meant the ability of a firm or group of firms to raise a price above the competitive level (the price which would emerge under conditions of perfect competition). Consequently, for antitrust analysis, the universe considered should not be the economic market but rather the relevant product and geographical space in which sellers would jointly be able to exercise significant monopoly power.

It follows that antitrust markets do not necessarily, and in general will not, coincide with economic markets, which are solely based on arbitrage. The difference can easily be explained by the following example. Consider two producers, A and B, that are present in the same economic market. If firm A raises the prices of its product in this market, arbitrage usually increases the sales of B. This leads to further adjustments that gradually eliminate the divergence between the price of A and B. Clearly, in such a situation, the presence of firm B weakens the potential market power that A could possess if B's output were held fixed, but does not necessarily eliminate all market power possessed by A. Thus, arbitrage tempers but does not necessarily eliminate market power.

3. How to define the relevant market: an analytical approach

The theoretical approach outlined in the previous section focused on the ability of sellers to exercise monopoly power over a well-defined product and geographical space. If the use of this monopoly power does result in a significant price increase, the space is defined as an antitrust market. Following this approach, the determination of an antitrust market requires the calculation of a price that a hypothetical profit-maximizing monopolist would set for one or several products and areas, which constitute the candidate antitrust markets.

Starting from one single product and the smallest possible geographical area in which the product is sold by one of the firms under investigation, a sequential process is followed where each time a next-best substitute is added to the preceding set. This leads to a series of candidate markets. A candidate market is then called an antitrust market if the price set by the hypothetical monopolist on that market would be significantly higher than the competitive price for the product or group of products.[1] The significant threshold for raising prices should not be too high (e.g. 5%), and could possibly vary according to the nature of product or area. The smallest candidate market for which such price increases would emerge is taken to be the relevant antitrust market.

[1] Alternative to the approach adopted in this paper, the US merger guidelines take the prevailing price as the benchmark for a price increase. The guidelines are basically concerned with the question whether or not the enhanced market power resulting from a proposed merger will raise prices from where they would otherwise be. In that sense, merger policy should be seen as preventive, designed to keep patterns from worsening. However, several scholars, including Schmalensee (1987) and Fisher (1987) state that the competitive price level would be a better choice, especially when merger policy can be a substitute for a structural policy towards oligopoly. It seems clear that in the case of the European Community, where the environment is rapidly changing and where various fundamental structural adjustments may threaten competition in the long run, the competitive price level is the better benchmark.

The actual test follows from the profit-maximization condition for the hypothetical monopoly or cartel of firms composing the candidate market. This condition states that for each product c in the candidate market, the monopolistic cartel should set a price, p_c, which deviates from marginal cost, MC, as follows

$$\frac{p_c - MC}{p_c} = \frac{1}{-e_{p_c}} \qquad (1)$$

where e_{p_c} stands for (negative) price elasticity of demand ($e_{p_c} < 0$).

Equation (1) can be manipulated to yield a clear test whether the cartel in the candidate market would raise price above the competitive price by at least the a priori fixed significance threshold. Formally, the candidate market is an antitrust market if for the product(s)

$$\frac{p_c}{p} = \frac{p_c}{MC} = \frac{e_{p_c}}{(e_{p_c} + 1)} > 1 + t \qquad (2)$$

where

p_c = the price set by the monopoly (cartel) for good c
p = the competitive price, equal to marginal cost under perfectly competitive conditions
t = the significance threshold (e.g. 5%)

The smallest antitrust market found in this way is taken to be the relevant market. Equation (2) assumes constant marginal cost. In case of non-constant marginal cost, the left side of the inequality should be multiplied by a factor υ, $\upsilon = MC_c/MC$, the ratio of marginal cost at the monopoly price to the marginal cost at the prevailing price (see Werden and Froeb (1992)).

If data were sufficiently available and e_{p_c} could be accurately estimated, relevant market delineation could be done with great precision. In the cases where this was feasible, the method has led to some interesting results (see, for example, Scheffman and Spiller (1987) and Froeb and Werden (1991) who point out several problems related to this method).

More importantly, inequality (2) provides us with a solid background and rigorous guidance for delineating the relevant market from less than perfect data. It is crucial to note that e_{p_c} in equations (1) and (2) is not equal to the conventional (Marshallian) partial demand elasticity.

The demand elasticity e_{p_c} in (1) is the elasticity of residual demand or cartel-specific demand for product c. While the partial elasticity of demand is calculated from the market demand for the product, assuming that only the price of product c changes, the elasticity of the residual demand incorporates, beside the partial elasticity, the effects from price adjustments and/or the adjustments of other marketing instruments for all other goods outside the monopolistic cartel in response to a change in price in the candidate market.[1] Formally,

$$e_{p_c} = e^d_{p_c} + \sum_{\substack{j=1 \\ i \neq j}}^{n} \sum_{i=1}^{k} e^d_{m_i^j} w_{m_i^j p_c} \qquad (3)$$

where

$e^d_{p_c}$ = the partial own-price elasticity of demand d for product c in the candidate market, or the percentage change in quantity demanded in response to a percentage change in price.

$e^d_{m_i^j}$ = partial elasticity of demand d for product c with respect to marketing instrument m_i^j used for another product j (m = price advertising etc.), or the percentage change of quantity demanded in response to a percentage change in marketing instruments used for product j from outside the candidate market.

$w_{m_i^j p_c}$ = reaction elasticity, i.e. equilibrium response elasticity of marketing instrument m_i^j with respect to the price set by the monopoly cartel, p_c, or the percentage change in marketing instrument m_i^j in response to a percentage change in the price set by the cartel for product c.

Thus, the elasticity of residual demand will be less negative, or lower in absolute (positive) value, if the partial market demand elasticity is low and if the cartel does not face aggressive competitive reactions from other products outside the cartel (i.e. lower price, increased marketing expenditure, etc.).

4. Basic determinants

The previous section showed how the potential to exercise significant monopoly power will be higher when, for the candidate antitrust market, demand elasticity is low and competitive reactions are not aggressive, but weak or accommodating.

This section presents a more detailed analysis of the driving forces behind these elements.

[1] Again this approach differs from the US test where it is assumed that other firms do not change their behaviour.

4.1. Factors related to partial demand elasticity

Demand elasticity defined as the sensitivity of market demand to price changes depends on several considerations related to the kind of product and the ease with which consumers switch to other products as a response to price changes. Among these factors are:

(i) The number of good substitutes available at competitive prices, which influence to a great extent the elasticity of the market demand for a product. Good substitutes are products that are functionally interchangeable and/or satisfy the same basic needs. The more substitutes, the higher the demand elasticity.

(ii) A basic determinant of the demand elasticity is the importance to the consumer of the product bought. A distinction should be made here according to whether the product is used as an input factor for a production process or whether the product is to be consumed as a final good.

If the consumer uses the product as an input factor for his production process, the elasticity will largely depend on the significance of the cost of the factor relative to the total costs. If the cost of that input factor is small compared to the total costs of the product, that consumer will be less sensitive to a price increase for the price rise will cause only a minor cost increase. If equally efficient input factors can easily be found with other suppliers, consumers will be more price sensitive.

When the product is used as a final good, the type of product and tastes come into play. When products are crucial to the consumer based on daily use or based on life-style, market demand tends to be less responsive to price changes. Luxury goods or goods for a purchase which is postponable, have a more elastic market demand.

(iii) In general, and controlling for other factors, a good that is very sensitive to changes in purchasing power (income) will also be more price elastic. This income effect will be stronger the higher the share of expenditure on this product in total expenditure by consumers.

(iv) The demand for a product tends to be more elastic the wider the range of uses of the product. Increases in price reduce the number of economical uses of a product, whereas price decreases expand the range of economically feasible uses.

(v) Price elasticity can be partly a function of the product durability because of the possibility of delaying the purchase of replacements. Postponing the purchase of a durable good by repairing it may be an effective substitute for replacing goods whose prices are rising.

(vi) The time it takes for the consumer to react to a price change has relevance to the demand elasticity. If, for some psychological or technical reason, the consumer cannot react immediately to a price increase, demand elasticity in the short run will be rather low. In this sense, market demand for a product tends to be more elastic in the long run than in the short run.

4.2. Factors related to competitive reaction elasticities

Among the many factors that may influence the strength of the diverse competitive reactions among firms, the following are important:

(a) Competitive reactions tend to intensify as the number of competitors increases. A greater number of firms reduces the possibility of coordinating actions and will easily lead to more aggressive reactions.

(b) Competitive reactions are stronger when demand for the product is growing slowly. In a rapidly expanding market, where forecasting is difficult, rivalry is often weakened by a capacity to benefit from the unexpected growth. Firms will not be tempted to capture market share from their rivals.

(c) Competitive reactions are more intense when competitors are tempted to use price cuts or other competitive weapons to boost unit volume.

(d) Competitive reactions are stronger when the products/services of competitors are not so strongly differentiated that buyers become locked in by the high costs of switching from one brand to another.

(e) Competitive reactions increase in proportion to the size of the pay-off from a successful strategic move. The greater the potential reward, the more likely some firms will give in to the temptation of a particular strategic move.

(f) Competitive reactions tend to be more vigorous when it costs more to get out of a business than to stay in and compete. The higher the barriers to leaving the industry, the stronger the incentive to firms to remain and compete, even though they may be earning low profits or even incurring losses.

(g) Competitive reactions become more volatile and unpredictable the more firms diverge in terms of their strategies, including the use of different marketing instruments, such as advertising, after-sales service, etc.

Competitive reactions and equilibrium responses for competing products crucially depend on the supply elasticity or the ease with which similar products can be supplied by other producers. Generally, it concerns companies already producing the product. However, following the arguments proposed by several scholars, including Landes and Posner (1981), producers who are currently not yet producing a product but who could easily enter the specific candidate market, should also be taken into consideration. For instance, vertically integrated firms who are currently producing a product for internal use could easily become new competitors to established suppliers. How fast must firms be able to shift among different products to conclude that they should be regarded as one market? Where is the barrier between substitutability and ease of entry (potential competition)? An important group of scholars answers this question by stating that only existing capacity which can be converted in the short run, without significant new investment in personnel training and equipment, should be referred to as substitute. In practice, one year is most often suggested as the relevant time period (Scherer and Ross (1990)). Others insist that also potential supply, that follows from quick and easy entry by new firms, has to be included.

In practice, several factors can give information about the expected magnitude of the supply elasticity, including:

Actual supply conditions

The consumer must have the opportunity to buy from other suppliers. If, for instance, a foreign supplier cannot distribute his products or if he cannot provide the required after-sales service, it will become extremely difficult for the consumer to switch to this supplier.

Similarly, some goods cannot be transported, for instance, perishable goods, and have to be bought locally.

Sometimes consumers incur switching costs when changing suppliers. They can also be locked into a contract with a certain supplier for some time, because of dedicated assets, know-how, software, patents or special designs.

If transportation costs represent only a small part of the total costs, one might expect suppliers to enter the candidate market or to increase their sales there, as long as a price increase causes the difference between prices in the candidate market and prices outside this market to exceed the transportation costs.

Supply substitution and potential supply conditions

If a new producer wants to enter the market or an existing producer wants to switch its production towards the product sold in the candidate market, they may incur significant sunk costs, i.e. costs that cannot be covered if the firm fails. This depends on the type of equipment used, whether the machines can be used for the production of other products or not, the durability of that equipment, etc. Large-scale investments in new equipment, advertising and R&D are often very risky and represent important sunk costs. These sunk costs can develop into effective barriers to entry in the candidate market and tend to decrease supply elasticity.

If a certain industry is in a position of overcapacity, it is more likely that producers within that industry will respond to a price increase of a product in the candidate market by producing a similar product and entering that market.

Government policy can, to a large extent, influence supply elasticity. Governments can limit entry into certain industries through measures like tariffs, quotas and price controls, but also with licensing requirements, quality requirements, safety and efficiency regulations or limits on access to raw materials. Also government subsidies to established firms may prevent new suppliers from entering that market.

Barriers to entry can be created by the distribution system. The more limited the wholesale or retail channels for a product and the more well-known the established brands, the tougher the access to the distribution system will be. Sometimes established suppliers have all distribution channels under their own control, so that entry by new suppliers is almost impossible.

For industries that require high R&D investments and for which long development periods and the hiring of highly skilled personnel are required, quick entry by new suppliers is less likely. If product know-how or certain design characteristics can be kept proprietary through patents, entry may even be completely blocked. Other cost disadvantages that can delay or deter entry are the control of established firms over access to raw materials and less favourable financing conditions for new firms.

Economies of scale can be a very effective measure for preventing entry. Small suppliers can face a cost disadvantage for a long time if cost and demand parity with the established firms can only be achieved after a long time and at a large scale. For small firms entry becomes very risky, unless they find a way in which to grow very fast, which is rather unrealistic for most industries. But also larger firms may refrain from entering such markets if there is a high risk of strong retaliation by incumbent firms. If the potential entrant expects the existing firms to react quickly and very strongly, entry will be deterred. Similar arguments apply with respect to learning economies or experience effects that can be kept proprietary.

If market demand is growing, it becomes more attractive for new firms to enter the market. If, however, the industry is facing a stagnating or even declining growth in demand, competition often turns into a battle for market share. New entry, especially in the case of large-scale entry, brings new capacity into the industry. This excess capacity places a downward pressure on the prices, thereby reducing the potential profits for the total industry. Firms, anticipating this evolution, will not easily enter this market or industry.

5. Application: The merger of Coca-Cola and Dr Pepper[1]

The judicial debate around the proposed merger of Coca-Cola and Dr Pepper may serve to illustrate the differences between economic and antitrust markets.

On 20 February 1986, the Coca-Cola Company announced its intentions to purchase the Dr Pepper Company and merge the operations of the two companies. Three and a half weeks earlier, PepsiCo had announced its intentions to purchase the Seven-Up Company, which was a subsidiary of the Philip Morris Corporation. These two mergers would have meant the consolidation, respectively, of the first (37,4%) and fourth (4,6%) and the second (28,9%) and third (5,7%) largest sellers of concentrate for carbonated soft drinks in the United States of America.

In June 1986, the Federal Trade Commission (FTC) decided that these mergers were likely to be anti-competitive and declared their decision to oppose them. In response to this opposition, PepsiCo and Seven-Up called off their merger, but Coca-Cola and Dr Pepper decided to face a trial in Federal District Court. Coca-Cola, Dr Pepper, PepsiCo and Seven-Up can be identified as producers of carbonated soft drinks (CSD). The main point of disagreement between the merging companies and the FTC was whether CSD was the appropriate market for judging the competitive consequences of these mergers or whether, for example, the market boundaries should be made much wider to include all potable liquids like fruit juices, milk, coffee, tea or other beverages.

In order to situate this problem, the following background information is useful. The national CSD producers are mainly manufacturers of flavouring concentrate. This concentrate is then sold to independent local bottlers, who add carbonated water and sweetener and package the finished CSD into bottles and cans. Bottlers provide the distribution function, delivering the packaged CSD to food stores, vending outlets and other retail outlets. Many bottlers also deliver syrup (concentrate plus sweetener) to restaurants and other outlets. Bottlers frequently handle more than one brand of CSD.

However, most manufacturers place restrictions on the ability of bottlers to handle several brands of competing manufacturers with similar flavours at the same time. Thus, in some area the local Coca-Cola bottler may handle Seven-Up, but he would never also distribute Pepsi or Royal Crown. In general, the bottlers are allowed a certain geographic area in which they are free to handle the distribution. In the 1980s, a few concentrate manufacturers, especially Coke and Pepsi, began absorbing some of their bottlers into the parent companies, so that the latter were becoming more vertically integrated. In the case of the merger of Coca-Cola and Dr Pepper, the Coca-Cola Company argued that Coke (and other CSD brands) had to face competition from all other beverages, not just from other CSD brands. They mentioned that during the past few decades, CSD consumption has been expanding substantially, primarily at the expense of more traditional beverages such as coffee. All these beverages, they stated, were actual and potential substitutes for CSD and hence competed with CSD. Also, as beverage manufacturers in general operated and sold their products on a national basis, as did Coke and Dr Pepper, they argued that the relevant geographic market should be the entire USA. In this large market, CSD consumption represented only 25% of total beverage consumption. Consequently, they argued that the merger would not increase their likelihood to exercise market power.

Their conclusions would indeed be correct in the event that their referential market would really be the relevant market. However, they took the total economic market as a reference, geographical (the total US market) as well as product-based (all potable liquids). Consequently, their potential market power was understated, and their analysis gave no objective and realistic overview of the possible dangers attached to the proposed merger.

The FTC, on the other hand, did not restrict its analysis to the economic market but tried to discover, like the procedures of the Justice Department suggest, the relevant antitrust market for this specific case. They thought that both the CSD concentrate market and the CSD market itself had

[1] This section is a summary of White (1989), pp. 80-98.

to be considered as the relevant antitrust markets for the purpose of analysing the competitive effects of a merger. Since the merging entities were sellers of CSD concentrate, the FTC claimed that CSD concentrate was a separate market. Also, because the CSD sellers could exercise some degree of influence on the wholesale and retail prices of CSD itself through sales promotions and direct discounts, CSD itself was also considered as a separate market. Further, because the CSD concentrate manufacturers also appeared to be able to influence prices separately (e.g. through specific rebates and promotions) in their different distribution outlets, the latter were also designated as separate markets.

With respect to geography, the FTC claimed that the relevant markets were the national market as well as local markets that could be approximated by metropolitan areas.

The FTC also argued that these markets were highly concentrated and that the proposed merger would increase the levels of concentration substantially. Furthermore, since entry by new producers or expansion by small existing producers seemed difficult, risky and time consuming, the merger was likely to result in a substantial lessening of competition.

Clearly, the latter analysis is based on the relevant antitrust market rather than on the economic market and shows in a much more detailed and objective way the possible consequences of the proposed merger.

The Judge's decision was in favour of the FTC, accepting many of the agency's crucial propositions and supporting arguments.

First, he argued that the relevant market was CSD. The relevant geographic markets were the entire USA and 32 'significant population areas' in the seven contiguous States of Texas, Louisiana, Mississippi, Alabama, Georgia, Tennessee and Arkansas.

Second, he argued that these markets were highly concentrated and Coke and Dr Pepper were active competitors in them. Finally, since a merger would reduce actual competition and entry into the market was not easy, he concluded that the proposed merger would have significant anti-competitive consequences.

6. The use of cross-price elasticities and price correlation techniques

6.1. Introduction

Many of the measures or methods that have been used to delineate antitrust markets focus more on economic markets than on antitrust markets. Notwithstanding this different approach, many of these methods contain interesting and useful elements for antitrust market determination. However, in some cases, these measures, if used unqualified, may lead to the wrong conclusions.

6.2. Substitution

In an excellent review of the literature, Fishwick (1985) shows how most of the different methods to identify substitutes in end-use all start from the same basic idea. They all take into account consumer psychology, physical or technical aspects, and time. Substitutability in consumption can generally be interpreted as the extent to which two products can be interchanged by a customer within a certain time period. Basically two aspects determine whether two products are 'reasonably' interchangeable: functional and reactive interchangeability. Functional interchange simply means that the two products must be able to carry out the same task. The reactive element encompasses the customers' response to a relative price change: when will they substitute one product for another (Schmidt (1981))? Another way to define a market is to take together the group of products which satisfy the same basic needs (Abbott (1955)). Focsaneanu (1975) criticized the basic need concept, arguing that it is very difficult, if not impossible, to gather the appreciation of all customers regarding certain products.

Schneider (1972) proposed to group substitutes, not according to the customers' point of view, but based on the perceptions of the producers. His idea is based on the presumption that a firm knows its competing firms as well as its potential competitors for a specific product (Fishwick (1985)).

Robinson (1933) introduced the idea of a 'gap' in substitution to define a market. Following this idea, once it becomes impossible to find a substitute for one product, there is a gap, and that is exactly where the boundaries of a market should be. In practice, however, such gaps may not always be found, since substitutes often form a continuum.

Using a more formal approach, Triffin (1940) proposed the 'cross-price-elasticity of demand' measure to identify a product's substitutes. The cross-price elasticity of demand for j with respect to the price of c is given by:

$$e\chi_{jp_c} = \frac{\delta q_j}{\delta p_c} \bullet \frac{p_c}{q_j} \qquad (5)$$

From a theoretical point of view, the cross-price elasticity seems an objective measure of substitution, but its practical application gives rise to several problems. For instance, the computation of the cross-price elasticity is only possible when the potential substitutes are well specified. Bishop (1952) also argued that the cross-price elasticity of demand for c with respect to the price of j should equal the cross-price elasticity of demand for j with respect to the price of c, if one wants to conclude that c and j are substitutes and, hence, belong to the same market. Otherwise careful examination is required.

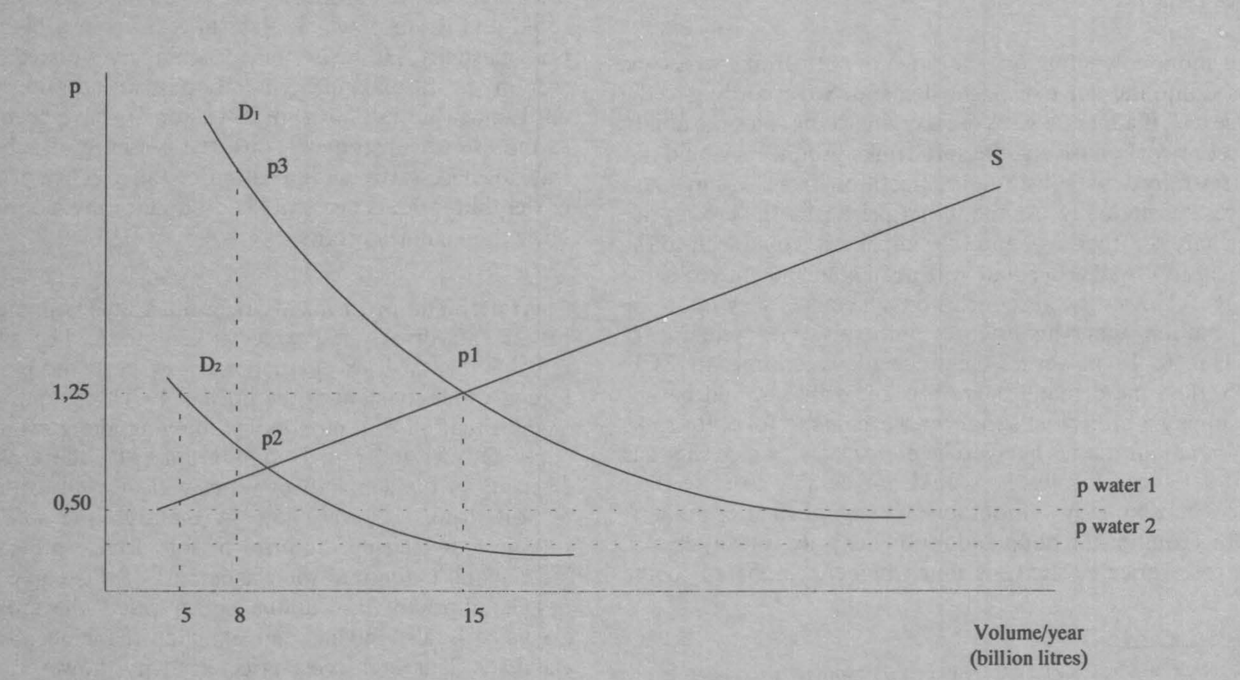
According to the model proposed in this paper, the essence of using cross-price elasticities lies in the following relationship between the partial own-price elasticity of demand for the candidate market and the cross-price elasticities.

$$e^{d}_{p_c} = -1 - \sum_{\substack{j \\ j \neq c}} \frac{\alpha_j}{\alpha_c} e^{\chi}_{jp_c} \qquad (6)$$

where α_j is the share of product j in income and expenditure by the (typical) consumer. Equation (6) shows that high cross-elasticities of demand will indeed lead to a high elasticity of demand for the candidate market for good c. The equation provides a justification for the use of the cross-price elasticity of demand for delineating a relevant market, but as explained in Section 3, in addition to the partial elasticities, competitive reaction effects have also to be included, and elasticities should be evaluated at the hypothetical monopoly price set in the candidate market. The latter point is important, since cross-price elasticities are very sensitive to the differences in the price levels between the substitute goods.

As to substitution in demand, it is believed that barriers to substitution will fall substantially when the price difference between two functionally interchangeable goods becomes very large. This will be reflected in a high cross-price elasticity, and thus in a more elastic demand curve. The dependence of cross-price elasticity and demand elasticity on price differences between two goods is illustrated in Graph 1. This graph shows in a simplified way the main relationships between the demand for soft drinks and the price for mineral water as a substitute. We assume that for these goods, income effects are rather marginal, so that substitution effects basically explain the change in consumption of the two goods. The horizontal axis shows the volume of soft drinks sold over a year in billions of litres. The vertical axis shows the price of a litre of soft drinks, expressed in ecus. Given a fixed price of water equal to ECU 0,50, demand for soft drinks is given by the demand curve D_1. We further assume that, given the supply curve S, the equilibrium price of soft drinks is ECU 1,25. The line D_2 shows what happens to the demand for soft drinks when the price of water is reduced to ECU 0,35. The curve's downward shift shows that to remain competitive, soft drinks must sell at lower prices. As

GRAPH 1: Demand elasticity and the price of a substitute



the price of water falls and the price of soft drinks does not adjust, users for whom the superiority of soft drinks is modest will shift to water. More precisely, given the original price of soft drinks of ECU 1,25 demand drops to 5 billion litres. The elasticity of demand for soft drinks at the original price of ECU 1,25 has also substantially increased.[1] Further adjustments will eventually bring the price of soft drinks down to equilibrium point p2.

If, for merger evaluation purposes, we use the cross-price elasticity test to determine whether soft drinks and mineral water should be placed in the same market, the result may strongly depend on the actual price levels of the two goods. For instance, with a given price of ECU 0,50 for a litre of water, the soft drinks demand curve equals D_1, so that the competitive equilibrium price for soft drinks is ECU 1,25 and some 15 billion litres are sold.

Suppose now a merger among several soft drinks producers gives them the power to raise prices. The central question is now whether they will be restrained from doing so by competition from mineral water producers. Let's first assume that the price of water does not change. The effect of substitute competition can be seen from the demand curve D_1. Suppose the price of soft drinks is raised by 10%, i.e. from ECU 1,25 to about ECU 1,38. The quantity of soft drinks demanded will fall to 14,2 billion, or by 5,3%. A 10% price increase leads to only a 5,3% reduction in quantity demanded, which means that the demand for soft drinks is price inelastic.

In a monopoly situation, the price of soft drinks would be raised into the range of elastic demand. So, according to the price test, if a merger gave the merging companies the ability to set prices collusively, the soft drinks producers would not be restrained by substitute competition from raising their prices substantially. At the initial price p1 , the cross-price elasticity is rather low, and the simple test would lead to the conclusion that water and soft drinks are not in the same market. However, this conclusion depends largely upon the assumption that the price of mineral water remains at ECU 0,50. If, however, the price of water falls to ECU 0,35, then the demand curve for soft drinks would be D_2. Assuming a rather flat supply curve, demand for soft drinks at this equilibrium is likely to be more elastic, which suggests that soft drink producers would not be able to raise their prices substantially without losing many of their customers. At this equilibrium point and for higher prices of soft drinks, the cross-price elasticity is much higher, compared to the first equilibrium. Thus, at these prices, the application of the simple test, will very likely come to the conclusion to include mineral water (as well as other liquids) into the relevant market, which may imply that the merger among the soft drinks producers does not need to be stopped.

This example clearly illustrates the sensitivity of cross-price elasticities to the actual price levels of substitute goods. Different from the simple cross-price elasticity test, the monopoly price test proposed in this paper evaluates cross-price elasticities and, ultimately, the elasticities of demand for soft drinks at the hypothetical monopoly price, for a price of mineral water that has fully reacted and reached an equilibrium in response to the change in price of soft drinks from the competitive level to the monopoly level. Moreover, instead of having to concentrate on measuring and interpreting the magnitude of these cross-price elasticities across different products and geographical areas without clear reference values, the test proposed in this paper is easier and focuses on the simple question: will the monopoly price in the candidate market differ significantly from the competitive price (see Section 3)?

The dependence of cross-price elasticities on actual price levels of the goods under consideration has, at least for one case, misled antitrust decisions. In United States v *E.I. Du Pont de Nemours and Co.* (1956), the Supreme Court decided that Du Pont did not have a monopoly over the market for cellophane. The Court based its decision on the fact that there were many substitutes for cellophane that customers could and did use, which also showed up in a high cross-price elasticity. However, this reasoning overlooked the fact that any profit-maximizing monopolist would raise its price until some (but not most) of its customers have been driven to the use of substitutes. Thus, the presence of substitutes was not necessarily an indication of the absence of market power, but rather a necessary condition for the monopolistic seller to maximize profits.

This interpretation problem can be illustrated with the example of soft drinks and water in Graph 1. The situation remains identical, except that we now keep the price of a litre of water constant at the price of ECU 0,5, and we look at the situation of a monopolist, moving along his demand curve D_1. At the initial equilibrium (p1), the cross-price elasticity of the demand for water with respect to the price of soft drinks is rather low. A monopolistic soft drinks producer, by raising the price of soft drinks, moves along his demand curve into the elastic part of this curve. In the new equilibrium (p3), at the higher price, the cross-price elasticity is also higher and explains the higher demand elasticity. This high cross-price elasticity, however, should not lead to the conclusion that at this price, a merger between

[1] Technically, a parallel inward shift or a shift with relatively larger effects for higher prices, will make demand more elastic.

soft drinks producers will not be anti-competitive. The monopoly price that is installed differs substantially from the competitive price, and a merger would only help to sustain this high price. In this case the higher cross-price elasticity reflects monopoly power actually used by the soft drinks producers and not the threat from the substitute product.

6.3. The use of price correlations and related techniques

Several scholars have argued that if the prices of reasonably close substitutes converge easily and rapidly to the same level, these products belong to the same market (Adelman (1951), Marshall (1952)). Similarly, it was argued that price equality generates objective indications for the boundaries of a market (Stigler (1947), Horowitz (1981), Stigler and Sherwin (1985)). Stigler and Sherwin state that it is not the absolute price levels at a certain point in time which should be compared, but the percentage change in the prices over time. They constructed the following equation:

$$\triangle \log P_c = a + b\,(\triangle \log P_j) \qquad (7)$$

If $a = 0$ and $b = 1$, c and j are perfect substitutes, hence, they should be included in the same market. According to the authors, their measure is more appropriate to determine substitution in end-use, than the attempts to use cross-price elasticity for this purpose. However, they recognize that their approach also has vulnerable points: how high must the level of correlation be to consider the two products as one market? Another weak point is that Stigler and Sherwin assume that the producers of c and j do not change their pricing strategy. Furthermore, a positive correlation between changes in prices of c and j does not necessarily prove that c and j are substitutes; it can also be a sign of complementarity between c and j.

In addition to pointing out several other statistical problems related to the use of correlation or regression techniques measuring price adjustments, Werden and Froeb (1992) point out a fundamental problem related to the use of correlation measures. This fundamental problem is based on the phenomenon that the economic factors that affect both price correlations and mark-ups do not affect the two in quite the same way. Their basic argument is that independent variation in cost or demand for two products or areas may induce a non-spurious correlation between the two products or areas which may be sufficient to put either in the relevant market for the other. However, the contrary may also hold. In some cases, dependent variations may not sufficiently show up in the measured price correlations. Werden and Froeb have illustrated the latter point in Graph 2. Consider a candidate market and a substitute outside it that may properly be part of the relevant market. Assume that it is possible to draw separate demand and supply curves for the substitute and assume that the only source of price variation for both the substitute and the candidate market is cost variation producing parallel shifts in the supply functions.

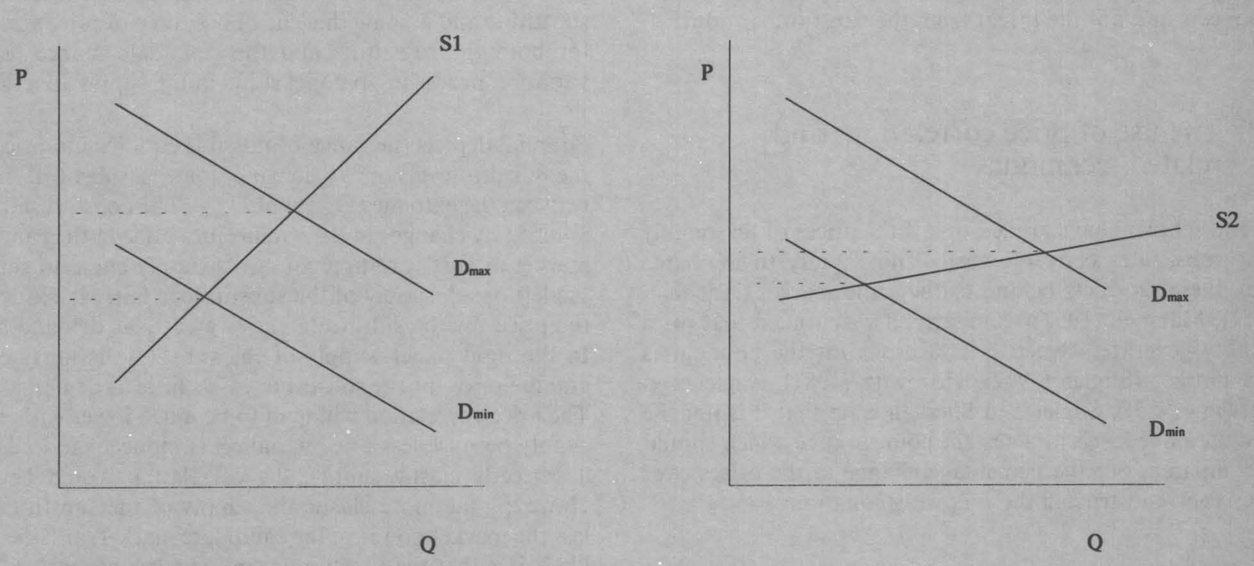
Graph 2 depicts the range of possible equilibrium prices for the substitute given, as demand for the substitute moves between the extremes D_{min} and D_{max}. The demand shifts are induced by changes in the equilibrium price in the candidate market as cost variation causes its supply curve to shift. In the left panel, supply of the substitute is fairly inelastic, and the price for the substitute varies greatly as demand shifts. In the right panel, supply of the substitute is fairly elastic and the price for the substitute varies little as demand shifts. The price correlation will tend to be much lower with elastic supply because less price variation is induced. Indeed, with a perfectly elastic supply, the correlation would be zero. However, the more elastic the supply of the substitute, the less the market power in the candidate market, and the more likely it is that the substitute is in the relevant market.

Therefore, the use of price correlation as the sole measure to delineate the relevant market may be quite misleading. Werden and Froeb (1992) show that other, more advanced, econometric techniques using price data to delineate antitrust market also suffer from statistical problems or are subject to the fundamental problem pointed out above. The methods they review are those proposed by the Shrieves (1978) test based on price equality; the Mathis, Harris and Boehlje (1978) test based on the relative speed of adjustment between prices; the Horowitz (1981) test based on price equality and absolute speed of adjustment; Klein, Rifkin and Uri (1985); Uri and Rifkin (1985); Uri, Howell and Rifkin (1985); Cartwright, Kamerschen and Huang (1989), the Granger causality test; Slade (1986), the exogeneity test; and finally, Whalen (1990), the cointegration test of price series.

6.4. The use of shipments data in geographical market delineation

In addition to the price tests discussed in the previous section, the degree of trade with other regions has been used as an important criterion to delineate a geographical market. Elzinga and Hogarty (1973 and 1978) advocate a test based on the 'little in from outside (LIFO)' and 'little out from inside (LOFI)' rules. Following the logic of the test, if 90%

GRAPH 2: Price correlation and supply elasticity

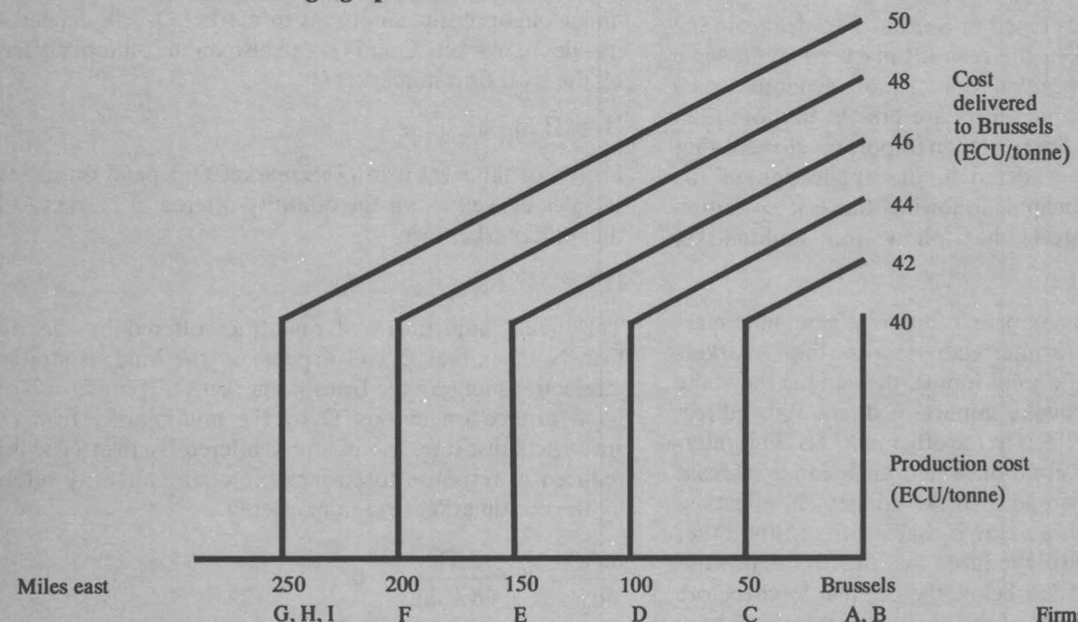


Source: Werden and Froeb (1992).

of the consumption of a specific product within an area is being produced within that area (LIFO) and if 90% of the output of this product realized in that area is being consumed within that same area (LOFI), then this area represents a geographic antitrust market. Besides these LIFO and LOFI rules, Elzinga and Hogarty also put forward other measures to define geographical antitrust markets. A certain region forms a market if constraining factors such as regulations or transportation costs are so high that consumers are constrained to buy within this region or outside producers are kept out of this region. Werden (1981) has criticized the shipments measure on two grounds. First, potential competition from producers outside the region may threaten producers in this region to such an extent that they will keep prices down. Actual trade flows may therefore be limited. The correct measure would have to include potential trade. The fundamental dependence of the pattern of shipments and the size of the relevant geographical market on price settings behaviour, can easily be illustrated with the graph below (see Scherer and Ross (1990), p. 179).

Suppose a merger is proposed between two paper suppliers A and B, both located in the vicinity of Brussels. All the other paper suppliers C, D, and so forth, are located in cities eastward from Brussels following the distances shown in Graph 3. Assume that each supplier has production and local delivery costs of ECU 40 per tonne. Shipping a tonne of paper to another city costs ECU 2 for every 50 miles of distance. Assuming that there are no physical limits on local supply, the competitive battle between firm A and B should result in a price for the Brussels consumer of approximately ECU 40. The ability of the merging firms A and B to raise the prices locally is, however, constrained by the possible shipments by more distant suppliers. Firm C could supply paper if the Brussels price is raised above ECU 42, firm D with a price elevation above ECU 44, and so forth. In this kind of situation, the central question is which firms can meaningfully constrain the actions of A and B, so that they can be considered as being in the same market. Therefore, it is necessary to decide, first of all, on how much the price in Brussels would have to be raised above the competitive

GRAPH 3: **Distance and the geographical size of markets**



Source: Scherer and Ross (1990), p. 179.

level in order to consider this a significant price increase. If we take for example the limit at 5%, i.e. a price of ECU 42, then the relevant set of suppliers for the Brussels paper market will include firms A, B and C. Thus the relevant market is in this case defined as the Brussels firms, along with all firms within 50 miles of Brussels. More distant firms are shut out of this market. Actual shipments data will not reflect this. For instance, the lack of actual shipments by C to Brussels may merely reflect that the actual price is set at a competitive level or less than 5% above this level in Brussels, and not refer to a significant segmentation of the market.

The second source of criticism is that, with strong price discrimination, it is quite possible that the exercise of monopoly power in two different regional markets goes together with important cross-regional shipments. According to the price test, if monopoly prices in the two (economic) regional markets differ significantly from competitive prices, the two regional markets constitute separate antitrust markets. The actual cross-regional shipments would misleadingly lead to the conclusion that the two regional markets should be grouped for antitrust analysis.

The foregoing arguments demonstrate that shipments alone are insufficient to define relevant geographic markets. However, as Werden observes, shipments data are very useful and can serve two related purposes. First, they can be used to draw preliminary boundaries from which to start in delineating relevant geographic markets. Secondly, they establish product flow patterns that form an essential part in the geographic market delineation process. The next appropriate step is to learn all about the economics that produce the observed shipments patterns, i.e. transportation costs, regulations, the kind of competitive behaviour, etc.

Having gone through the different steps, it becomes possible to delineate geographic markets. As Werden observes, the geographic markets will often correspond to the markets that came out of the shipments tests, making the conclusion all the more confident. However, this will not always be the case; sometimes the geographic markets will differ substantially from the areas delineated by the shipments tests.

7. Multimarket oligopoly

Following the logic developed in Section 2 to delineate the relevant antitrust market, the relevant market may in some cases also be much larger than one or more economic markets, especially if the same sellers are present in more than one economic market. Therefore, an important element that should be explicitly considered in the application of the market-delineation principle, following the test condition in Section 2, is the effects that follow from multimarket competition.

Since these firms often compete in different economic markets with costs that are interrelated across these markets (e.g. through the use of a joint input), the actions they take in one market may provoke important direct and indirect (strategic) adjustment effects in the other markets. This interrelatedness may lead to situations where an action to increase profits in one market would provoke adjustment effects in another market to such an extent that profits in the other market would be so sharply reduced that the overall profitability of the firm might fall below the original level (before the firm took any action). This possibility seems to have important implications for the market delineation principle. Indeed, the principle requires firms to collude as a monopoly, to increase price for the product in any candidate market. Let us take a particular economic market for a well-defined product as a candidate market. A monopoly price implies that the quantity offered has to decrease, which in turn, when costs are interrelated across markets, may lead to adjustments in another market that could make overall profits of the colluding firms fall below original levels. In such cases the colluding firms will refrain from setting a high price in the particular candidate market. Consequently, the particular economic market cannot be considered as an antitrust market.

In order to illustrate the essence of this case, assume that there are two economic markets, C and O and two firms, one multimarket firm that is present in markets C and O and one firm denoted by superscript N, i.e. only present in market O. Market C is considered as a candidate antitrust market. In addition, the costs of the multimarket firm are assumed to be interrelated across markets. Thus, total costs do not only depend on the quantity produced for market C, but also on the quantity produced and sold on market O, q_o.

$$C = C(q_c, q_o)$$

With oligopolistic competition in market O, the actions by the multimarket firm for market O, which we reduce here to quantity settings, will not be independent from the quantity of the good offered by the rival firm N in market O, $q^N{}_o$, and vice versa.

With these assumptions, it follows that total profits of the multimarket firm operating as a monopoly in market C and under oligopolistic conditions in market O, will depend on its sales in markets C and O, and also on the quantity offered by the rival firm in market O.

$$\Pi = \Pi\,(q_c, q_o, q^N{}_o)$$

Profits of the rival firm N in market O depend on its level of sales as well as on the quantity offered in market O by the multimarket firm.

$$\Pi^N = \Pi^N\,(q^N{}_o, q_o)$$

The actual adjustment of quantities offered by the rival firm N in market O will depend on the kind of strategic interactions among the firms in market O. If for firm N the good offered on market O by the multimarket firm is a strategic substitute, the quantity offered by firm N will be reduced in response to an increase of the quantity offered by the multimarket firm in market O.

$$\frac{dq^n{}_o}{dq_o} < 0 \text{ if } \frac{\partial^2\Pi^N}{\partial q^N{}_o \partial q_o} < 0$$

The last term represents the effect on marginal profit of the firm N in response to an increase in sales by the multimarket firm on market O and indicates whether the goods are strategic substitutes (< 0) or strategic complements (> 0) on market O (Bulow, Geanakopolos and Klemperer (1985)). Let us further assume that for the multimarket firm, there are joint economies across the two markets, which may result from economies of scale and/or scope.

$$\frac{\partial^2\Pi}{\partial q_o \partial q_c}$$

Formally, we assume > α (< 0 denotes joint diseconomies)

With joint economies across these two markets, it is clear that an increase in sales in the candidate market will decrease the marginal costs of the firm in the candidate market as well as in the other market. Therefore, with lowered marginal costs, the multimarket firm will also increase sales in the other market. If the product is a strategic substitute to the competing firm in that market, the increase in sales will lead to a decrease in sales by the competing firm N, which effect would induce the multimarket firm to further increase sales in market O. In such a case the strategic indirect effect reinforces the direct effect from economies of scale. Clearly, within such a scenario, it becomes less likely that the multimarket firm in market C would do the opposite and would prefer, following profit maximization, to substantially reduce quantity and raise price significantly above the competitive level in market C. If for these reasons the multimarket firm prefers to keep the price in market C very low, insignificantly different from the competitive level, market C cannot be considered as an antitrust market. This, of course, is an extreme case. Within more general oligopolistic frameworks with many multimarket competitors and joint economies across markets, the likelihood that an economic market will fall together with an antitrust market will indeed become very small.

The reasoning developed so far also holds when strategic complements occur together with joint diseconomies across markets or if demand is interrelated across markets. Possible interaction effects could also be extended to other instruments than price and quantity setting (e.g. advertising).

From a geographical market perspective, the joint economies across economic markets and strategic interactions suggest that in the delineation of a relevant antitrust market, it is important to explicitly consider exports (based on economies of scale) and foreign investment (based on economies of scope) through which firms may compete and/or meet in several (national) markets.

Using a somewhat different line of reasoning some authors, including Scott (1991), have argued and have presented evidence that multimarket contact may facilitate oligopolistic collusion, because oligopolists meeting in several markets have more opportunity to monitor each other and to learn to cooperate. They can also exercise more collusive discipline by having the possibility to retaliate in several markets to a non-coordinated action by one of the multimarket players. Such behaviour leads the firms to agree collusively on what the optimal collusive prices are in the different markets where they meet without allowing disruptive behaviour in any of the markets.

It is also clear that in this case the relevant antitrust market will not necessarily coincide with one or a subset of several economic markets, but may be much larger and embrace the set of markets subject to coordinated actions by multimarket competitors. Important cross-export flows and foreign direct investment flows may again give a first indication of the importance of these phenomena.

8. Application: Do national boundaries delineate antitrust markets?

The delineation of the relevant antitrust markets for assessing a merger is not an easy task and requires an in-depth analysis of the competitive dynamics surrounding the merging firms. However, as argued above, the collection and systematic representation of available data on consumption patterns as well as on geographical patterns of shipments and a multimarket presence of firms represent a useful first step in the delineation of antitrust markets. The observed patterns may give us a first-cut impression — but not more than that — of the extent to which exposure to inter-regional trade or to the presence of multimarket competitors may constrain collusive actions in a certain candidate antitrust market.

It is within this context of preliminary analysis that we address the question as to what extent national boundaries may possibly delineate antitrust markets. We use Belgium as an example because reliable data are available. Clearly this first-step analysis cannot provide complete answers, and the results are subject to the criticisms raised in the foregoing sections. Because of data restraints, we are also forced to work with three-digit NACE industries which are often too broadly defined for this kind of analysis.

Exposure to international trade competition is measured through the value of exports X and imports M into Belgium. A distinction is made according to the trading partners: X_{ec} (M_{ec}) exports (imports) to EC Member States and X_{nec} (M_{nec}) exports (imports) to non-EC countries.

The trade exposure measure XM used in the analysis divides the sum of the exports and imports by the sum of all shipments, including domestic shipments for the year 1985. In order to come to meaningful classifications, a somewhat arbitrary cut-off rate of 30% is used to classify transactions as domestic or national if $XM < 30\%$. A further division is made according to the geographic concentration of international trade transactions. Transactions are classified as European if XM is larger than 30%, without significant trade with non-EC countries ($XM_{nec} < 0,30 * XM$), i.e. transactions are global if $XM > 0,30$ and $XM_{nec} > 0,30 * XM$.

Multimarket competition originating from the presence of multinational corporations (MNCs), is taken into account by introducing the measure FP (foreign participation), indicating the presence of multinational firms in the country. FP is defined as sales by multinational firms (domestic- and foreign-based) divided by total sales by all firms producing in the country. A distinction is made between participation by multinationals based in EC countries (FP) and non-EC based multinationals (FP_{nec}).

As with the trade data, a cut-off rate of 30% is used to distinguish European industries characterized by the presence of foreign rivalry ($FP > 30\%$) from strictly national rivalry in the country ($FP < 30\%$). Similar to the trade subdivisions, foreign rivalry is further subdivided into European competition present in Belgian industry ($FP > 0,30$ and $FP_{nec} < 0,30 * FP$) or global competition ($FP > 0,30$ and $FP_{nec} > 0,30 * FP$).

The combination of trade and foreign presence tends to characterize competition which, in turn, suggests the scope of significant competitive interaction and, thus, as a first-step indicator, the likely geographical scope of the relevant antitrust market.[1]

Table 1

Competitive interaction: Belgium

Foreign participation	Trade exposure		
	$XM < 0{,}30$	$XM > 0{,}30$ $XM_{ncc} < 0{,}30 * XM$	$XM > 0{,}30$ $XM_{ncc}\ 0{,}30 * XM$
$FP > 0{,}30$ $FP_{nec} > 0{,}30 * FP$	**Global multinational**	**Global European**	**Global**
$FP > 0{,}30$ $FP_{nec} > 0{,}30 * FP$	*European multinational*	*European*	**Euro-global**
$FP < 0{,}30$	National	*Poly-national European*	**Poly-national global**

In Table 1, the labels in the different 'cells' of the matrix-figure denote the type of competitive interaction. The industries which belong in the upper-left cell of the matrix are ones where global competition stems from the presence of global multinational corporations that have spread their activities across different countries, so that even in the absence of trade, competitive interactions across countries may occur. In the terminology of Porter (1986) or Doz (1986) such industries are multidomestic industries characterized by MNCs that benefit from economies of scope across markets and exploit their intangible assets (technology, brand names, management skills) in the local national markets. Their competitive position in local markets must be sustained through coordinated actions worldwide. The cell just below characterizes industries where such competition is confined to the European Community, without a significant presence of competitors from outside the Community.

The cell at the bottom left characterizes industries where competition is mainly local, where firms do not seem to gain specific advantages from a worldwide configuration or coordination of their activities. It is most likely that these industries are characterized by local competition so that for a small country such as Belgium the relevant market may coincide with the national boundaries.

At the extreme right, the upper cell is for industries where competition is global through the interactions among integrated MNCs which coordinate their sales and export operations via a well-organized worldwide configuration of their activities. The cell just below characterizes industries where mainly European multinationals are present on the Belgian market. The cell at the bottom denotes industries where competition is global through the worldwide exports of firms which are localized in one single country.

The middle column of the matrix characterizes industries where transactions are strongly concentrated in the EC market, but where competition is likely to be global through the presence of global MNCs (upper mid-cell) or European because of the presence of European-integrated MNCs and important European trade flows (mid-cell). The bottom cell suggests that competitive interactions occur mainly through exporting activities.

Following this classification scheme, the cells with italic type characterize European competition, while the cells with bold type characterize global competition. For all these cases, antitrust markets are likely to be much larger than the Belgian market. It is only for industries in the extreme left cell at the bottom that there is a higher likelihood of competition being national, such that antitrust markets may coincide with Belgian markets. However, as argued before, in some of those industries, competition may be very local, such that the relevant antitrust markets may turn out to be substantially smaller.

Conclusions

The delineation of antitrust markets has been the subject of substantial debate and controversy in the literature. The lack of uncontested operational procedures makes it very difficult to enforce antitrust laws in these cases where it is necessary to clearly define a dominant market position.

The present paper attempts to contribute to resolving some of this controversy by presenting a solid theoretical model that relates the ability and intentions of a dominant firm to raise the price above the competitive level, to the set of products and geographical areas the firm necessarily needs to control in order to effectively do so. The smallest set found in this way is identified as the relevant market. The model proves to be very useful for the collection and organization of data concerning the behaviour of firms and the markets in which they operate. In making the theoretical relationships explicit and relating them to some of the measures actually used by antitrust practitioners, the paper analyses the theoretical consistency and limits of some of these measures.

Finally, an extension of the model investigates the effects originating from multimarket competition.

[1] The combination of trade and multinational investment to characterize competition has been suggested in the strategic literature; see, for example, Doz (1986) and Kesteloot and Veugelers (1990).

Table 2

Classification of Belgian industries according to trade intensity and the presence of MNCs

Global multinational	
429	Manufacture of tobacco products — European multinational
427	Brewing and malting — national
243	Manufacture of concrete, cement or plaster products for construction purposes
422	Manufacture of animal and poultry foods (including fishmeal and flour)
Global European	
223	Drawing, cold rolling and cold folding of steel
242	Manufacture of cement, lime and plaster
247	Manufacture of glass and glassware
251	Manufacture of basic industrial chemicals and manufacture followed by further processing of such products
252	Manufacture of chemicals obtained from petroleum and from coal
253	Manufacture of other basic industrial chemicals
255	Manufacture of paint, painters' fillings, varnish and printing ink
256	Manufacture of other chemical products, mainly for industrial or agricultural purposes
258	Manufacture of soap, synthetic detergents, perfume and toilet preparations
312	Forging, drop forging; closed die-forging, pressing and stamping
316	Manufacture of tools and finished metal goods, except electrical equipment
321	Manufacture of agricultural machinery and tractors
342	Manufacture of electrical machinery
343	Manufacture of electrical apparatus and appliances for industrial use; manufacture of batteries and accumulators
345	Manufacture of radio and television receiving sets, sound equipment; manufacture of gramophone records and pre-recorded magnetic tapes
346	Manufacture of domestic-type electric appliances
347	Manufacture of electric lamps and other electric lighting equipment
351	Manufacture and assembly of motor vehicles and manufacture of motor vehicle engines
353	Manufacture of parts and accessories for motor vehicles
413	Manufacture of dairy products
414	Processing and preserving of fruit and vegetables
418	Manufacture of starch and starch products
419	Bread and flour confectionery
423	Manufacture of other food products
453	Manufacture of ready-made clothing and accessories
466	Manufacture of articles of cork and of straw and other plaiting materials; manufacture of brushes and brooms
472	Processing of paper and board
481	Manufacture of rubber products
482	Retreading and repairing of rubber tyres
483	Processing of plastics
European	
26	Man-made fibres industry
311	Foundries
315	Boilermaking, manufacture of reservoirs, tanks and other sheet-metal containers
352	Manufacture of bodies for motor vehicles and of motor-drawn trailers and caravans
421	Manufacture of cocoa, chocolate and sugar confectionery
424	Distilling of ethyl alcohol from fermented materials; spirit distilling and compounding
439	Miscellaneous textile industries
465	Other wood manufacture (except furniture)
494 + 495	Manufacture of toys and sports goods; miscellaneous manufacturing industries
Poly-national European	
231	Extraction of building materials and refractory clays
241	Manufacture of clay products for constructional purposes
244	Manufacture of articles of asbestos
245	Working of stone and of non-metallic mineral products
246	Production of grindstones and other abrasive products
248	Manufacture of ceramic goods
313	Secondary transformation, treatment and coating of metals
314	Manufacture of structural metal products
327	Manufacture of other machinery and equipment for use in specific branches of industry
341	Manufacture of insulated wires and cables
412	Slaughtering, preparing and preserving of meat
415	Processing and preserving of fish and other seafoods fit for human consumption
417	Manufacture of spaghetti, macaroni, etc.
428	Manufacture of soft drinks, including the bottling of natural spa waters
43	Textile industry
438	Manufacture of floor coverings
441	Tanning and dressing of leather
442	Manufacture of products from leather or leather substitutes
451	Manufacture of mass-produced footwear
455	Manufacture of household textiles and other made-up textile goods
456	Manufacture of furs and of fur goods
462	Manufacture of semi-finished wood-products
463	Manufacture of carpentry and joinery components and of parquet flooring
464	Manufacture of wooden containers
467	Manufacture of wooden furniture
473	Printing and allied industry

Global

257	Manufacture of pharmaceutical products
322	Manufacture of machine-tools for working metal, and of other tools and equipment for use with machines
324	Manufacture of machinery for the food, chemical and related industries
325	Manufacture of plant for mines, the iron and steel industry and foundries, civil engineering and the building trade
326	Manufacture of transmission equipment for motive power
328	Manufacture of other machinery and equipment
330	Manufacture of office machinery and data-processing machinery
344	Manufacture of telecommunications equipment, electrical and electronic measuring and recording equipment, and electro-medical equipment
361	Shipbuilding
363	Manufacture of cycles, motor-cycles and parts and accessories thereof
371	Manufacture of measuring, checking and precision instruments and apparatus
372	Manufacture of medical and surgical equipment and orthopaedic appliances
373 + 374	Manufacture of optical instruments and photographic equipment; manufacture of clocks and watches and parts thereof

Euro-global

211 + 212 + 221	Extraction and preparation of metalliferous ores; iron and steel industry
224	Production and preliminary processing of non-ferrous metals
259	Manufacture of other chemical products, chiefly for household and office use
471	Manufacture of pulp, paper and board

Poly-national global

222	Manufacture of steel tubes
232 + 239	Extraction of minerals
323	Manufacture of textile machinery and accessories; manufacture of sewing machines
362	Manufacture of standard and narrow-gauge railway and tramway rollingstock
364 + 365	Manufacture and repair of aerospace equipment and transport equipment
411	Manufacture of vegetable and animal oils and fats
416	Grain milling
420	Sugar manufacturing and refining
425 + 426	Manufacture of wine and of cider
461	Sawing and processing of wood
491	Manufacture of articles of jewellery and goldsmiths' and silversmiths' ware; cutting or working of precious and semi-precious stones
492 + 493	Manufacture of musical instruments; photographic and cinematographic laboratories

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Oligopolistic dominance and EC merger policy

P. J. Williamson[1]

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1. Introduction

(a) This paper draws together existing theoretical and empirical evidence on the conditions under which a merger is likely to give rise to oligopolistic dominance. It then deploys these insights, along with the results of a brief survey of existing national policies, to suggest practical indicators which might form the basis of future EC merger policies.

(b) Section 2 suggests a definition of oligopolistic dominance and briefly discusses how this differs from the parallel definition of single firm dominance. Section 3 identifies four schools of thought concerning the conditions which give rise to oligopolistic dominance. Specifically, the 'concentration' school, the 'coordination' school, the 'contestability' school and the 'cross-parry' school. The market characteristics which each school suggests should be taken into account in assessing the probability that oligopolistic dominance will arise from a merger are then discussed in detail.

(c) In Section 4 we examine to what extent these insights have been reflected in the design and implementation of existing national policies in the USA, UK, Germany, France and Italy and what other considerations these policies have taken into account. Section 5 of the paper then sets out a specific set of indicators which might be examined in order to implement:

(i) a rapid initial screening of proposed mergers; and

(ii) a framework for detailed analysis of those identified as creating a significant risk of oligopolistic dominance in their 'relevant markets'.

The design of each indicator is explained and its strengths and limitations assessed. The object of this final section is to initiate and focus discussion of the practical policy alternatives.

2. The definition of oligopolistic dominance

(a) The concept of 'market dominance' occupies a central role in EC policy towards mergers. A primary objective of this policy is to prevent the creation of dominant market positions which would be detrimental to the structure of competition in the Community or impede integration of markets into a single internal market.

(b) Single firm dominance has been interpreted by the Court of Justice as a position of economic strength which allows an undertaking to behave to an appreciable extent independently of competitors, customers and ultimately of consumers.[1] Our first task in this paper must be to consider the appropriate extension of this concept to the realm of oligopolistic dominance.

(c) We propose the following definition of oligopolistic dominance and then explore its implications:

Oligopolistic dominance exists when a small group of firms are in a position to coordinate their respective actions so that one or more of these firms has scope to behave to an appreciable extent independently of other competitors, customers and ultimately of consumers in a market or set of related markets.

(d) While this definition parallels that for single firm dominance, two additional aspects merit further comment. First, the existence of oligopolistic dominance requires more than just the existence of a market or set of markets where the number of suppliers is few. The structure of the market must also be such that a group of these firms can effectively coordinate their actions. Without coordination the concept of joint dominance by more than one firm has no meaning. The very existence of oligopolistic dominance therefore depends on scope for a particular type of market conduct.

(e) As in the case of single firm dominance, it is assumed that the two formerly separate managements will act as one after the merger. But for a merger to create oligopolistic dominance it must also create scope for coordination between the new entity and some of the remaining firms. We cannot simply assume this condition is satisfied. Nor can we impute it from market concentration measures alone. As we shall see below, a richer set of indicators of structure and conduct is required.

(f) A second aspect of note is that the definition above allows for the possibility that oligopolistic dominance in one market may be promoted if the competitors also meet each other in other, related markets. Thus oligopolistic dominance may arise from coordination which involves a set of related markets. This possibility is explored more fully later in this paper.

(g) Based on this definition we now turn to consider the main theories of the process by which oligopolistic dominance emerges, related empirical evidence and the implications for policy towards mergers.

1 See, for example, judgments of the Court in *Hoffmann-La Roche* [1979] ECR 461 and *Flat Glass* [1992] paragraph 358.

3. Theoretical insights and empirical evidence

(a) In the case of pure monopoly there are clear-cut solutions to the firm's problem of deciding on price and output (at least so long as we assume managers seek to maximize profits and that they hold definite expectations concerning future demand and cost conditions). This is not true for oligopolies. The outcome depends on what assumptions a firm makes concerning the behaviour of its rivals. As a result, some economists claim that the oligopoly problem is indeterminate. While strictly correct, however, this does not mean that prediction of the outcome based on the structural indicators and past conduct is impossible. Rather, it suggests we need to extend the set of these indicators beyond the realm of simple cost functions and market elasticity of demand.

(b) Although not absolutely clear cut, models of oligopolistic behaviour can be roughly divided into four schools:

(i) the 'concentration' school — which views concentration as the primary driver behind oligopolistic dominance operating through three channels. First, it informs us that the level of concentration determines the ability of a group of oligopolists to coordinate their actions. Second, it shows that the incentive to collude generally rises with the level of concentration. Third, it suggests that if we assume that a group of firms are able to collude, then the loss of welfare to consumers will rise with the level of concentration. According to this school, the impact of a merger can be assessed by examining its impact on concentration.

(ii) the 'coordination' school — which emphasizes the question of whether the merger will substantially change the likelihood of the leading firms maintaining a tacit oligopolistic bargain. It suggests that tight coordination between suppliers will be possible at much lower levels of concentration in some kinds of markets compared with others. Hence there are two key questions. First, does the merger substantially change the level of concentration so as to leave the market in a position where coordination between only a very few large firms could determine prices? Against this test, small changes in concentration are likely to be of little consequence since they will seldom cause a fundamental change in the ability of the leading firms to collude. Second, does the market structure and past conduct facilitate collusion or militate against it? Where the market characteristics facilitate coordination we should be wary of mergers which lead to moderately high concentration, while in some other markets, collusion will be impossible to maintain even where a merger results in very high concentration. According to the coordination school, in order to assess at what level of concentration collusion is likely to be a problem, we need to consider jointly many factors including: the availability of focal points, a high degree of similarity between competitors, levels of product differentiation, entry and exit barriers, the divisibility of investments, etc.

(iii) the 'contestability' school — which holds that even if a merger creates the conditions for effective oligopolistic coordination, no welfare loss will persist beyond the very short term so long as the market is highly 'contestable'. A market is perfectly contestable when firms can move in and out of the market rapidly without incurring substantial losses on exit. When the economics of the market make it very imperfectly contestable, generally because any entrant must incur substantial sunk costs which would be lost if forced to exit, an oligopoly will be sheltered from new competition. Low contestability is therefore seen as the primary prerequisite before there is risk of welfare loss from a merger even in a highly concentrated industry.

(iv) the 'cross-parry' school — which argues that oligopolistic dominance which may be difficult for a group of firms to achieve if they compete in only one market, may be more easily secured when the same group of competitors potentially meet in multiple markets. Stable coordination will be more easily maintained if competitors have multimarket contact, opening the way for 'cross-parries'. From a policy standpoint this implies that we should be more concerned about mergers where the remaining players also meet in other markets. Second, that acquisitions in related markets which increase multimarket contact among a potentially dominant group of oligopolists should be of policy concern.

(c) The main theoretical underpinnings and empirical evidence for each of these schools is outlined below. Clearly, they are not necessarily mutually exclusive.

3.1. The concentration school

3.1.1. The extensive theoretical literature on which the views of the concentration school are based has two broad conclusions in respect of mergers, namely:

(i) that the probability of sustaining effective tacit coordination between oligopolists in a market will rise with the level of concentration. Thus mergers which increase concentration to levels where coordination might be possible are suspect;

(ii) that, if oligopolists in a market do collude, then the welfare loss to consumers will rise with the level of concentration. Hence, mergers in already highly concentrated markets which increase concentration further will increase the welfare loss to consumers of these products or services.

3.1.2. The first of these conclusions itself arises from the effect of concentration on the ability of firms to effectively coordinate their actions combined with the fact that concentration generally increases the incentive to coordinate.

3.1.3. In the case of the incentive to collude, it can be shown that the incentive rises both with the level of concentration and the equality of market shares among the large firms. Thus in assessing the effect of a merger on the incentive to collude we need to look at its effect on:

(i) the level of concentration in the relevant market;

(ii) the degree of inequality between the shares of the large firms. To the extent that a merger reduces inequality between the large firms' market shares, there will be increased incentive for these firms to tightly coordinate their prices (Markham (1951), Sleuwaegen (1986)).

3.1.4. As regards the impact of concentration on the ability of the firms to coordinate, the argument rests on the fact that the number of two-way flows of information required to make coordination viable rises by the combinatorial of the number of firms ($n(n-1)/2$ where n is the number of firms). Thus once we move away from the situation where coordination between a very few large firms is sufficient to enable them to exert market power, oligopolistic dominance is unlikely to arise because coordination between more than a handful of firms is generally impossible.

3.1.5. From a practical point of view, the problem with these arguments is that the theory does not tell us what level of concentration is sufficiently high for firms to have both a strong incentive and an ability to coordinate their actions, or, to put it another way, the level of concentration below which we should have little fear of effective oligopolistic dominance arising through coordination.

3.1.6. Many threshold levels have been suggested as indicators of the point below which coordination of too many firms would be required to form a group sufficiently dominant to exert market power. The results of Bain's original study (1956) implied that if coordination of more than eight firms was required to control 70% of the market, dominance is unlikely to arise. Subsequent studies on US data suggest that oligopolistic dominance is unlikely if coordination of more than four firms is required to control 50% of the market. (Dalton and Penn (1976), Geithman et al. (1981)). Looking at data on geographically isolated monopolies, duopolies and oligopolies in retail and professional services, Bresnahan and Reiss (1991) find that once an oligopoly involves more than three firms, effective coordination and oligopolistic dominance break down. This latter evidence, in contrast to earlier work, would suggest that unless a merger leaves a market with no more than about three major players, then the risk of oligopolistic dominance is limited.

3.1.7. From the standpoint of practical policy implementation, the idea of a critical concentration threshold is an attractive one. The evidence suggests that it may be appropriate to use such a threshold to clear mergers which have a low risk of imposing welfare losses on consumers (except where barriers to mobility within the market are important — a point to which we will return). For concentration levels above the chosen threshold, however, there is a great deal of debate about how much we can impute about the risk of oligopolistic dominance by looking at the margin by which concentration exceeds the threshold. Specifically there is debate about the following question: to what extent does the amount by which post-merger concentration exceeds the threshold range provide a reliable indicator of increased risk of oligopolistic dominance? In other words, should we be equally concerned about oligopolistic dominance arising from any merger which pushes concentration above the threshold, regardless of by how much? Alternatively, should we be much more concerned about those mergers which push concentration towards very high levels and more sanguine about a merger which takes market concentration only just beyond the threshold range? Again there are obvious implications for the design of policy.

3.1.8. As we have noted, the concentration school believes that the amount by which concentration exceeds the threshold level is a good indicator of the risk of oligopolistic dominance. It also contends that when concentration levels are already high, then mergers which further increase concentration will increase the loss of consumer welfare.

3.1.9. The latter contention flows from theoretical models which have demonstrated that, under plausible conditions, if we assume a group of firms act so to take account of their mutual dependence then any further increase in concentration will reduce the welfare of consumers, other things being equal (Willig (1991), pp. 288-9). On this basis the concentration school argues that mergers in markets with already high concentration are inherently suspect. They suggest that even small increases in concentration will increase the loss of consumer welfare and that the loss goes on growing the bigger the increase in concentration. Thus mergers causing large rises in concentration are more damaging than mergers which only marginally increase concentration, even if firms continue to operate with unchanged assumptions about their competitors' behaviour (these assumptions are termed 'conjectural variations'). The case against a merger which results in a large rise in concentration will be even stronger if it allows the leading firms to improve their conjectures about the way competitors will behave so as to more closely coordinate their actions.

3.1.10. Both of these results imply that we will observe a positive and continuous relationship between concentration and profitability above some concentration threshold. Not so many years ago the existence of a reliable, continuous (generally linear) positive relationship between concentration and industry profitability was almost taken as an article of faith by empirical, industrial economists. Recent empirical evidence has raised doubts. Surveying the empirical evidence for the USA in 1990, Scherer and Ross (1990, p. 411) conclude:

'However, recent work has demonstrated that most, if not all, of the correlation between profitability and concentration found by Bain and his descendants (at least for the United States) was almost surely spurious — the result of aggregating a positive relationship between sellers' market shares and profitability to the industry level. This finding complicates the evaluation of the structure-conduct performance paradigm, because it is consistent with several alternative explanations of firm behaviour and industrial performance.'

Fairburn and Geroski (1989, p. 191) surveying the British evidence conclude:

'The concentration-profits relationship in the UK is weak, non-linear, and dependent on other factors; it seems to have disappeared in [as from] the 1970s. ... the growing awareness of the limitations of previous studies ... has led to a move to close studies of particular industries. Such studies certainly validate concern that the impact of market power is more complex than is allowed for in simple concentration indices, but in many cases market power most certainly does exist.'

3.1.11. These findings have important implications for merger control. In particular, they suggest that the precise amount by which a merger would increase concentration is a very unreliable guide to its likely impact on industry performance. Instead we should limit our reliance on measures of concentration to help answer a different set of questions, namely:

(i) Would the level of market concentration after the merger be above the low-risk threshold?

(ii) If so, does the merger increase the incentive for a group of major firms to collude by making their market shares more equal?

3.1.12. The degree to which the post-merger level of concentration exceeds the threshold would then be only one of a portfolio of indicators used to determine how great is the risk of substantial welfare loss from oligopolistic dominance.

3.2. The coordination school

3.2.1. We have already noted that perhaps the most robust empirical relationship between concentration and scope for oligopolistic dominance arises from the fact that, once the number of firms necessary to form a group capable of exerting market power passes a certain level, coordination becomes impractical. The coordination school takes this logic further. It points out that there are also many other factors which may affect the degree to which a group of oligopolists are able to coordinate their actions in order to distort competition to their advantage. Thus, even if the number of significant players in a market is few, these other market characteristics may militate against coordination, ensuring a low risk of oligopolistic dominance. Conversely, other markets may be particularly susceptible to tacit coordination, creating scope for oligopolistic dominance despite the need to involve a larger number of significant players. In this case oligopolistic dominance would be viable at a much lower concentration threshold.

3.2.2. The roots of the coordination school date back to Fellner's (1949) analysis of the oligopolistic bargain. Many factors have been advanced since. With an eye to the practical implementation of indicators discussed in Section 5, we focus on seven influences with fairly general applicability across markets: product heterogeneity, focal points, operating leverage, buyer concentration, ordering patterns, technological uncertainty and market growth, and supplier diversity.

Product heterogeneity

3.2.3. If the products in a market are perfectly homogeneous, there remains only one dimension on which a group of oligopolists must coordinate in order to distort the market: the price dimension. As products become more heterogeneous the magnitude of the coordination problem rises quite dramatically and the likelihood of oligopolistic dominance declines. If there are stable differences in the quality of products offered by different firms, then coordination must cover both the average price level and the differentials. If sellers are located at varying distances from buyers and transport costs are significant, then price coordination must handle cost pressures for different producer prices in different geographic markets. If demand for the product designs offered by different suppliers varies substantially across time, as is the case with a fashion good, then it will be difficult to discourage those whose product is temporarily less fashionable from initiating a price war. Finally, if the products are complex and at least partly customized, so every order is different from the next, then coordination on price can be rendered problematic.

3.2.4. The broad conclusion from this analysis is that oligopolistic coordination is less likely to arise the more heterogeneous are the products in the market. Other things, being equal, we should be most concerned about scope for oligopolistic dominance in markets where products are relatively homogeneous.

3.2.5. One important caveat is worth mention here. This analysis assumes that the heterogeneous products compete with each other in the same 'market'. It may be, however, that product differences allow suppliers to segment the market into protected niches, so that price coordination can occur among a relatively homogeneous set of products within each niche. Whether or not this problem is likely to arise depends to a large extent on the definition of the 'relevant market' adopted in the merger policy. Given the practical limits to implementation of a policy based on very narrow market definitions, however, the possibilities for creating a stable intra-industry structure as the basis for coordination are likely to be important. They are considered in more detail in the next section.

Focal points

3.2.6. Given that restrictive trade practice laws deal with explicit collusive agreements, the risk of oligopolistic dominance of relevance to merger policy relates to the possibility of tacit coordination. Various types of conduct may produce focal points which facilitate coordination. This suggests that policy should consider whether the past conduct has established focal points which make effective coordination more likely with any given number of competitors. Examples of such conduct include:

(i) The use of 'price lining' — commonly accepted price points such as UKL 9,99, UKL 19,95, or UKL 199. In many retail markets these price points provide norms for different types of goods and quality levels on which suppliers can focus to assist price coordination.

(ii) The use of 'round number discounting' — in many industries it is accepted practice to give round number discounts of, say, 10 or 15% off a published list price to certain customers or in certain situations. The list price provides a focal point and the round number discount provides a signal to competitors of the form: 'I don't wish to set off a price war and continue to respect the focal point, but in this specific case, I feel I must cut the price.' This last role is important because it places natural floors on discounting and tends to avoid a spiral of incremental price cutting becoming established.

(iii) The use of 'rule of thumb' pricing — such as cost plus 40%. If suppliers have similar costs these types of pricing formulae will again provide focal points for tacit coordination of prices.

(iv) Regular, periodic price adjustments — annual price revisions, for example, which act as focal points in the time dimension, alerting firms to watch their competitors for signals about their pricing intentions for the next year. Under these conditions a 'barometric price leader' is more likely to emerge around which price changes can be coordinated.

3.2.7. The existence of focal points is potentially significant for the process of integration towards a single market within the EC. Oligopolists who recognize their mutual independence will be particularly sensitive to the risks of causing historic national price umbrellas to collapse as cross-border sales expand. By accepting prevailing pricing practices and taking advantage of historic focal points, competition can be restricted to non-price forms and price wars can be avoided.

Operating leverage

3.2.8. Operating leverage refers to the ratio between fixed costs and total costs. When operating leverage is high, the profitability of the business is very sensitive to capacity utilization. This reflects the fact that when output is falling total costs fall much more slowly. Conversely, rising sales add little to total costs provided that spare capacity is available. Most of the marginal revenue of an additional sale therefore shows up as profit.

3.2.9. Since the short-term profit improvement from an extra unit of sales is large in industries with high operating leverage, so are the incentives to attempt to 'cheat' on tacit coordination of prices. Whenever there is underutilization of capacity in such environments, there is a strong incentive for an individual firm to attempt modest price cutting in the hope of capturing some extra sales without setting off a price war. Oligopolistic coordination therefore tends to be unstable in industries with high operating leverage. Coordination is particularly difficult where high operating leverage is accompanied by cyclical demand, exit barriers and indivisible 'lumpiness' of capacity. The latter characteristic eliminates the option of shutting capacity incrementally so as to reduce the burden of operating leverage.

3.2.10. By contrast, in markets where operating leverage is low and/or capacity can be reduced and expanded at relatively low cost as demand changes, so that profits are less sensitive to capacity utilization, then oligopolistic coordination is likely to be more viable.

Buyer concentration

3.2.11. If oligopolists face a concentrated set of buyers, then the loss of an individual customer will have a relatively large impact on an individual firm's profitability. Again, this will be particularly true if it faces high operating leverage. The stability of oligopolistic coordination therefore tends to be lower when buyers are concentrated — a seller's resolve to stick to the rules of tacit coordination tends to wane in the face of losing a large customer.

3.2.12. Care must be exercised, however, in simply concluding that buyer concentration will eliminate scope for oligopolistic coordination. As we discuss in more detail below, if buyers face unusually high switching costs, the oligopolists are likely be in a position to maintain their prices above competitive levels since even large buyers lack a credible threat against an individual supplier.

Ordering patterns

3.2.13. Oligopolistic coordination is most likely to be viable in markets where orders are small, frequent and regular. As we have already noted, an individual firm's incentive to depart from tacit coordination depends on the size of the potential gains compared with the risk of a sustained loss of profits if such a departure sets off a price war. In an environment with small, frequent orders a firm would have to regularly cut prices in order to accumulate a substantial increase in sales. Observing this repeated price cutting, it would not be long before the remaining competitors concluded that tacit coordination had been violated. Collapse into a price war would be the likely outcome. A pattern of small, frequent orders therefore tends to bias the risks and rewards against breaking tacit coordination of pricing.

3.2.14. Where customers request quotations on large orders relatively infrequently, by contrast, a large, short-term reward is available to an individual firm who captures a particular order by slightly underbidding its rivals. At the same time, each firm may rely on the fact that cutting price once does not necessarily confirm that coordination has collapsed — rivals may excuse the behaviour as an aberration. If one or more firms within the oligopoly takes this view each time an order comes along, however, intended coordination will be undermined. Oligopolistic dominance is therefore more difficult to maintain in markets where each order is large and the flow of orders is infrequent and irregular.

Technological change and market growth

3.2.15. Just as with product heterogeneity, a high level of technological change and uncertainty is likely to undermine continued oligopolistic coordination. Opportunities for the individual suppliers to establish their proprietary technology as the accepted market standard by cutting prices and building volume rapidly, for example, increase the incentive to abandon tacit coordination with rivals. Likewise continual product changes as technology advances reduce the comparability of prices and upset historic focal points. Of course to the extent that competitors form alliances to develop common base technologies or to spread risks by agreeing on common standards, some of these impediments to coordination may be mitigated.

3.2.16. Rapid growth in market demand, meanwhile, may encourage firms to compete aggressively for market share in the expectation that they will be able to maintain this larger share when the market matures, hence increasing their long-term profits.

3.2.17. Where technology is mature and growth is slow, by contrast, firms often recognize that market share is difficult to wrest from competitors. The effective coordination by a group of large suppliers necessary to underpin oligopolistic dominance is therefore more likely to emerge.

Supplier diversity

3.2.18. Finally, the greater the diversity among suppliers the more difficult will be coordination. We have already dealt with the tendency for quality differentials to complicate the task of tacit coordination on price under the heading of product heterogeneity. However, the presence of other differences between suppliers is also likely to impede effective coordination particularly across time.

3.2.19. The first reason is that if suppliers have different cost structures which arise from influences such as their base technology, location or organizational systems, then they will be differentially impacted by different types of external shocks. Suppose, for example, that one producer uses a labour intensive process while another serving the same oligopolistic market has adopted a highly capital intensive process. At a certain point in time their costs may be equal. When there is rapid wage inflation, however, the first producer will wish to raise prices more than the second. His more capital intensive counterpart, on the other hand, will be looking for larger price increases when real interest rates rise. Rules of thumb such as cost-plus pricing, which may have provided producers with similar cost structures with workable focal points, will no longer provide an effective means of tacit coordination. When diversity leads to different producers suffering different types of cost shocks at different times, coordination becomes difficult to sustain.

3.2.20. The second reason is that when suppliers find themselves competing in a market with firms who have different histories and accumulated experience of the way competition works, the subtle communication required for tacit coordination is more likely to break down. The same signal will have different meanings to different players.

3.2.21. Over time some of the impact of initial supplier diversity will be reduced as competitors learn from experience in the market. The impact of different cost structures reacting to external shocks, however, may permanently reduce the scope for oligopolistic coordination. Conversely, where producers have similar cost structures and a long history of competing in the same set of markets, the risks of oligopolistic dominance are higher for industries with a few major players.

3.3. The contestability school

3.3.1. The contestability school holds that high concentration and excellent opportunities for coordination between a group of large firms is of no practical consequence if other firms can move in and out of the market without incurring significant losses on any investment required — i.e. the market is 'contestable' (Baumol (1982), Baumol and Willig (1986)). As soon as a group of competitors try to exploit potential for oligopolistic dominance by increasing prices, then 'hit and run' entrants will see the opportunity for quick profits and drive prices back down.

3.3.2. Many have criticized contestability theory, claiming that while it is a neat theoretical concept, almost no examples of contestable markets exist in practice because entry into virtually every market requires a firm to make sunk-cost investments. The costs of establishing specialized capacity, branding, customer or distributor training, and contracting costs, etc. would be sunk costs to the extent that, if the investment were subsequently liquidated, the proceeds would be substantially less than the cumulative sum expended. Given that sunk costs cannot be recouped, a 'hit and run' entrant would incur losses. Knowing this, they would avoid such kamikaze behaviour.

3.3.3. The concept of contestability, however, should not be dismissed so lightly for two reasons. First, in the context of open economies, 'hit and run' entry might not be so impractical after all. Second, the conditions for non-contestability provide important insights into market characteristics which will encourage the emergence of oligopolistic dominance.

Trade and contestability

3.3.4. Whether or not the potential for trade flows will render a market contestable depends on the extent to which sunk-cost investments are required to establish trade. The conditions for contestability on the basis of trade are that:

(i) a potential import supplier has spare capacity available or that if investment in capacity is required, it can be switched to serve another market at low cost;

(ii) any unsold stock placed in the target market could be liquidated on exit at close to its full cost, including the costs of transport;

(iii) that specialized, non-recoverable investments in distribution, marketing or product redesign required to sell into the market are negligible. This might be the case, for example, where the product could use already established distribution channels and facilities and no investment in branding was required;

(iv) contracting and transaction costs required to establish a flow of imports are low.

3.3.5. Under these conditions, the possibility of profitable 'hit and run' entry by importers will act as an effective discipline against oligopolistic dominance by a group of players inside the market. The more closely these conditions are approximated, the more powerful the discipline arising from trade potential. In markets where import sales must be supported by investments in specialized capacity, stocks, distribution infrastructure, marketing or contracting which cannot be recouped should the supplier be forced to exit, the mitigating influence of potential trade on oligopolistic dominance will be weak.

Sunk costs and non-contestability

3.3.6. Trade is an important special case of the positive relationship between market contestability and the threat of entry as a force counteracting potential for oligopolistic dominance. Three main factors act as primary determinants of the degree of contestability and hence the threat of entry.

3.3.7. The first, as already noted, is sunk costs. Salop (1991, p. 317) puts the case succinctly: 'Successful entry is not a certain proposition. Entry may fail because the entrant's costs are relatively high, its products prove to be unpopular, the economy enters a serious recession, or entry sets off a price war. Entry is a financially risky proposition to the extent that entry costs are sunk. As a result, by raising the entrant's financial exposure, sunk costs reduce the likelihood of entry.'

3.3.8. When sunk costs are substantial, a second factor, scale economies, comes into play. Scale economies may rationally cause the potential entrant to fear that it will be unable to win sufficient share against established rivals to survive, or that intensified competition caused by his entry may lead to lower prices and hence losses.

3.3.9. The third important aspect associated with contestability is the time required to enter. If entry takes a long time to effect, the threat of entry is less likely to deter post-merger price rises. Established firms can earn excess profits in the interim period. Moreover, entry is less likely to be attractive because instead of catching established firms with 'hit and run' entry, they have substantial time to reduce their own prices before the entrant can earn revenue.

Intra-industry structure and barriers to mobility

3.3.10. Contestability theory also has other important implications for the existence of oligopolistic dominance once we admit the possibility that intra-industry structure within our definition of the 'relevant market' may play a role.

3.3.11. One of the primary objectives of competitive strategy at firm level is the creation of 'protected positions' within a market where a firm or small group of firms is sheltered from competition (see, for example, Porter (1980)). This can be potently achieved if a firm is able to accumulate tangible and intangible assets which enable it to serve a particular group of customers or product line either at lower costs or in ways which reduce substitutability with other competitors' offerings. This may involve investing in customer-specific relationships, brands, product innovations, distribution and service networks, etc. Clearly once it became obvious that such a strategy provided increased profits, other competitors or new entrants would be eager to emulate the strategy. In many cases, however, this would require substantial sunk-cost investments. A rival or entrant, for example, may spend a considerable amount of money on adjusting the product specifications to meet more closely the needs of a particular group of customers, or in building a brand which it expects to be attractive to them, only to find that it is unable to win share in the face of competitive reaction from the early strategic innovators. To the extent that such investment represented sunk costs, rivals or entrants may rationally be wary of attempting to emulate the strategic innovators. Therefore a 'non-contestable' strategic group of early innovators may arise within an industry. Caves and Porter (1977) coined the term 'barriers to mobility' to describe the existence of sunk-cost protection around imperfectly contestable strategic groups comprising one or more firms.

3.3.12. The existence of strategic groups in an industry has potentially important implications for oligopolistic dominance. Recall that the coordination school argued that product heterogeneity and supplier diversity complicated the formation of an oligopolistic bargain and therefore raised the concentration threshold above which oligopolistic dominance was viable. However, if product heterogeneity and supplier diversity lead to the fragmentation of a market into strategic groups, each protected by barriers to mobility, then these characteristics may actually increase the probability of oligopolistic dominance arising. By reducing the number of immediate competitors to those within the protected strategic group, the ability of firms within the group to coordinate pricing decisions could rise dramatically. Scherer and Ross (op. cit., p. 284) summarize the problem as follows: 'Product heterogeneity greatly complicates the way industry members interact with one another. While it inhibits the ability of the industry as a whole to coordinate prices and production, it may permit individual firms or clusters of firms to exploit monopoly power relative to certain classes of buyers.' In this case, effective oligopolistic dominance may arise even at relatively low levels of concentration measured at industry level.

3.3.13. These issues are likely to be of particular relevance to the process of single market completion. Faced with the threat of increased competition as the protection of barriers around national markets falls away, firms will rationally look for new strategic groups around which they can rebuild protective barriers. This search is likely to centre on pan-European groups of customers with similar needs or preferences or geographic markets with somewhat peculiar customer requirements. Once identified, mergers may play a critical role in the formation of new strategic groups within which oligopolistic coordination is viable. This would be achieved by the merger of firms with similar sets of customers and differentiated assets (such as proprietary technology or brands) so as to reduce the number of players who could compete on a similar basis without making new, sunk-cost investments.

3.3.14. Conduct which promotes the emergence of strategic groups essentially divides the problem of oligopolistic coordination across an entire industry into two sets of interactions: behaviour within a strategic group and competition between strategic groups. Competition between strategic groups is muted by the need for sunk-cost investments before a firm can emulate the strategy of firms in the group. Competition within each group is minimized when each group contains a sufficiently small number of similar firms so that coordination is facilitated. A merger may make an important contribution to satisfying the second condition.

3.3.15. Under these conditions, standard industry concentration measures will not identify the potential for oligopolistic dominance. There may be a number of strategic groups, each comprising two or three firms, so that measured industry concentration is relatively low. One obvious suggestion for dealing with this problem is to redefine the 'relevant market' to encompass one particular strategic group.

3.3.16. Theoretically, the relevant market could be defined by separately analysing each of the products of the merging firms and asking the question: could a hypothetical monopolist over this product raise its price by x% or more, where x% is some significant price rise? A 5% rise, for example, is used in the US guidelines (Willig, op. cit.). If such a hypothetical monopolist would profitably raise its price by x% or more, then this initial product alone is defined as comprising the relevant market. If we believe this would not be possible due to close substitutability with another product, then this product would be included in the relevant market before posing the same question as to whether a monopolist over this market would be able to profitably raise prices. This sequence would continue until enough products were included to answer 'yes' to the possibility that a monopolist would increase prices.

3.3.17. In some cases this may allow a single strategic group to be identified as the relevant market. To see how this routine may break down in practice, however, let us consider a specific example — the market for industrial sewing thread which is a critical input to the garment-making industry. Since there are virtually no good substitutes for sewing thread in garment construction (unlike repair), the hypothetical monopolist with control over the product would be able to profitably raise prices. Suppose then that in this relevant market there was an important strategic group of four firms who had invested in a computer system to amass information on customer needs and buying cycles, an extensive network of local distribution centres, specialized stocks and flexible manufacturing systems. Through this investment and accumulated experience of order patterns, these firms were able to provide next-day supply of any one of 20 000 colours and types of thread to those garment-makers with very uncertain daily mix of work. Rivals and new entrants are dissuaded from attempting to emulate this strategic group by the fact that the required investments involve substantial sunk costs.

3.3.18. Suppose then that two of the four firms in this strategic group propose to merge. With three remaining firms with very similar shares, oligopolistic coordination within the group is considered likely. Yet there are other firms with substantial shares outside the strategic group so that concentration measured across the industry as a whole is below our policy threshold.[1] Do we attempt to redefine the relevant market as 'industrial sewing thread available in 20 000 varieties delivered to the customers' premises the next day after order'? The practical difficulties are obvious. Yet this is not necessarily an isolated example. Similar problems may arise in a range of industries with potential for firms to supply differentiated product-service bundles to specific customer groups where the protection of sunk-cost investments makes coordination among a few similar firms viable. These might include machine tools, specialist industrial consumables, pharmaceuticals, recorded music, and so on.

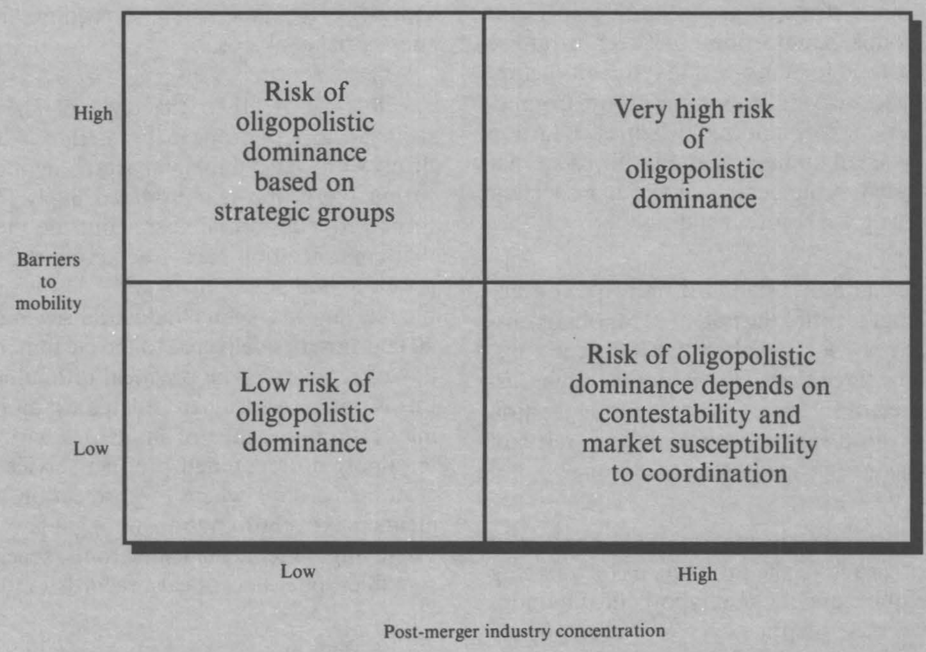
3.3.19. This analysis suggests we might usefully divide industries into four categories based on industry concentration and intra-industry barriers to mobility as shown in Graph 1.

3.3.20. In the top right-hand quadrant, concentration above the threshold level is combined with the possibility that individual firms or small groups of firms can form protected strategic groups which further divide the total number of competitors, leading to a high risk of oligopolistic dominance. In the bottom right quadrant, the risk of oligopolistic dominance depends whether the characteristics of the market identified by the coordination school are such as to facilitate or hamper coordination. Such coordination will only be sustainable, however, if market contestability is low. In the top left quadrant, measured concentration may be relatively low, but if it is possible to form tight strategic groups, barriers to mobility will assist the emergence of oligopolistic dominance. Finally, with low concentration and low barriers to mobility, oligopolistic dominance is unlikely to arise in the lower left quadrant.

3.3.21. Potential for the emergence of tight strategic groups protected by barriers to mobility is obviously complex and therefore difficult to measure and predict. One possible measure is the extent to which the market has exhibited a

[1] In fact, this example closely parallels reality in the US market (see Williamson (1991)).

GRAPH 1: **Industry concentration and barriers to mobility**



history of stability of market shares among competitors. The applicability and implementation of this indicator is explored in Section 5 of this paper.

3.4. The cross-parry school

3.4.1. Competition and merger policy has traditionally not considered the possibility that multimarket contact among suppliers might facilitate oligopolistic consensus among sellers in one or more of these markets. Bernhiem and Whinston (1990), however, demonstrate that multimarket contact is irrelevant to the sustainability of oligopolistic coordination only when identical firms meet in identical markets. Under more realistic conditions, multimarket contact can have very real effects on competition.

3.4.2. The first important result from theory is that where cost differences exist between firms and markets then multimarket contact makes it optimal for firms to tacitly agree 'spheres of influence' which distort competition and facilitate collusion. Edwards (1964) recognized that this effect appeared to exist in Europe noting that: 'Each conglomerate competitor ... may informally recognize the other's primacy of interest in markets important to the other, in the expectation that its own important interests will be respected.'

3.4.3. A powerful special case of the above arises where a group of firms use acquisition to create a network of credible threats and counter-threats. Suppose, for example, that we begin from a position where a number of firms potentially compete in the EC market, but that for historical reasons (such as barriers to trade) each major firm dominates its home market. With the completion of the single market, each firm fears a threat to its home sphere of influence as other large firms expand outside their home markets. Suppose that each firm then acquires a small supplier which operates in its most feared potential competitor's home territory. These small firms can be used to threaten damaging retaliation against any competitor who tries to expand in their opponent's main market. Any competitor cutting price in the home market of an opposing firm would suffer an immediate price attack in its home market by the small subsidiary, backed by its new parent (behaviour known as a 'cross-parry'). Regional expansion would therefore carry more than the cost of low profits in the new market. It would also mean lost profits on a large market share in the home market. Through this network of threat and counter-threat across a series of related geographic or product markets, a group of oligopolists can keep prices artificially high.

3.4.4. The second main result is that the presence of multimarket contact may strengthen the disciplinary threat against a single market competitor and hence help to maintain stable oligopolistic dominance in that market. Consider, for example, the case where there are three competitors in a market who could potentially coordinate their actions to distort that market. Suppose that firm 1 acquires another company in a second highly concentrated market, bringing it into multimarket contact with firm 2 who already operates in both markets. Now before the acquisition, firms 1 and 2 individually may have been wary of punishing firm 3 if it decided to cheat on a tacit agreement to collude for fear of setting off a full-scale price war. After the acquisition, however, firms 1 and 2 can signal an intention to maintain collusion through the second market and simply direct the punishment solely at firm 3's customers. Knowing this, firm 3 will tend to maintain collusion.

3.4.5. There are two important policy implications. First, we should be more concerned about mergers which generate scope for oligopolistic dominance in a particular market where the same players also meet each other in other markets.

3.4.6. Second, we should be concerned about the spillover effects of acquisition in a related market where this will increase multimarket contact between a small number of leading players in a particular market (Scott (1991)).

3.4.7. The main market characteristics which these theoretical 'schools' suggest need to be considered by a policy for merger control are summarized in Table 1. We now turn briefly to discuss the policy guidelines in operation in the USA and major European countries, before making proposals for a policy framework to assess the potential impact of mergers on oligopolistic dominance within the EC.

4. Merger control and oligopolistic dominance in the USA, UK, Germany, France and Italy

(a) In examining the merger policies of the USA and major European countries, the focus is on the way they handle

Table 1

Theoretical and empirical insights on the emergence of oligopolistic dominance — A summary

Structural characteristic	Conduct characteristic	Predicted impact on dominance	Uncertainties
Post-merger level of concentration		+	Threshold or continuous?
Increase in concentration		+	Threshold or continuous?
Equality of large firms' shares		+	Dominance based on mobility barriers?
Product homogeneity		+	
Focal points	Pricing policies, transparency and serial correlation in history of prices	+	
Operating leverage, lumpy capacity increments and barriers to exit	Underutilized capital	–	
Buyer concentration	Frequency of switching between suppliers	–	
	Ordering patterns (frequent, regular)	+	
	Technological change	–	
Market growth		–	
Supplier diversity		–	
Low sunk-cost barriers to expansion of imports		–	Relationship to 'relevant market'?
Low sunk-cost barriers to rapid new entry		–	
Presence of strategic groups within the industry protected by mobility barriers		+	Relationship to 'relevant market'?
Multimarket contact		+	

the issues around the definition of oligopolistic dominance which they seek to control and the indicators used. In some cases, however, it is necessary to describe briefly the broader context of control of single firm dominance. Where possible the link between the policy and the theoretical and empirical evidence described above is identified.

4.1. United States of America

4.1.1. The US policy towards mergers starts from the premise that any increase in concentration in already highly concentrated industries poses the threat of welfare loss. It also adopts the strict interpretation of the concentration school that the larger the increase in concentration associated with a merger in an already concentrated market, the larger the likely welfare loss. Regardless of whether a merger is likely to lead to single firm dominance or oligopolistic dominance, it is subjected to a precise concentration test based on the 'relevant market'.[1]

The concentration test

4.1.2. Following the major changes in the US merger guidelines in 1982, market concentration measured by the Herfindahl-Hirschman index (HHI) and its change have taken centre stage, acting as the sole initial screen. The critical HHI thresholds set down by the policy, along with the likely action at each level, are set out in Table 2. The threshold below which mergers are generally assumed to pose little risk of either single firm or oligopolistic dominance is roughly equivalent to a market made up of 10 equally-sized suppliers. Thus many more mergers are likely to be caught in this screen and subjected to further analysis than the theoretical and empirical analysis above would imply are high risk.

Table 2

The US market concentration test

Pre-merger HHI range	Change in HHI due to merger	Policy response
> 1 800 (Equivalent to six roughly equally-sized firms)	≥100	Likely to challenge
> 1 800	50 to 100	Challenge depends on other aspects of market structure
1 000 to 1 800	< 100	Unlikely to challenge
1 000 to 1 800	> 100	Challenge depends on other aspects of market structure
< 1 000 (Equivalent to 10 roughly equally-sized firms)		Unlikely to challenge

4.1.3. These HHI thresholds were reaffirmed in the new merger guidelines published in late 1991. However, the new guidelines introduced an adjustment to the computation of the concentration index to reflect the high contestability of some markets. This amounts to including any potentially profitable 'hit and run' entrants as if they were already established in the market.

4.1.4. Specifically, in computing the HHI and its change, however, potential entrants can be included under the strict condition that they are what is (rather confusingly) termed 'uncommitted' competitors. An 'uncommitted' potential competitor is defined as an entrant who can come into the market without 'significant sunk cost'. Sunk costs (which cannot be recovered were a competitor to leave the market) are considered 'significant' if they account for 5% or more of the total costs of entry — in which case the potential competitor must be excluded from the HHI calculation. Competitors who would require only cash or other generally available assets to enter, by contrast, can be included in the HHI even if these are hypothetical, with the result that highly 'contestable' markets will usually escape the HHI screen.

4.1.5. Mergers which fail to pass the concentration screen then have the opportunity to be cleared on any one of five other sequential tests. These are outlined in Graph 2.

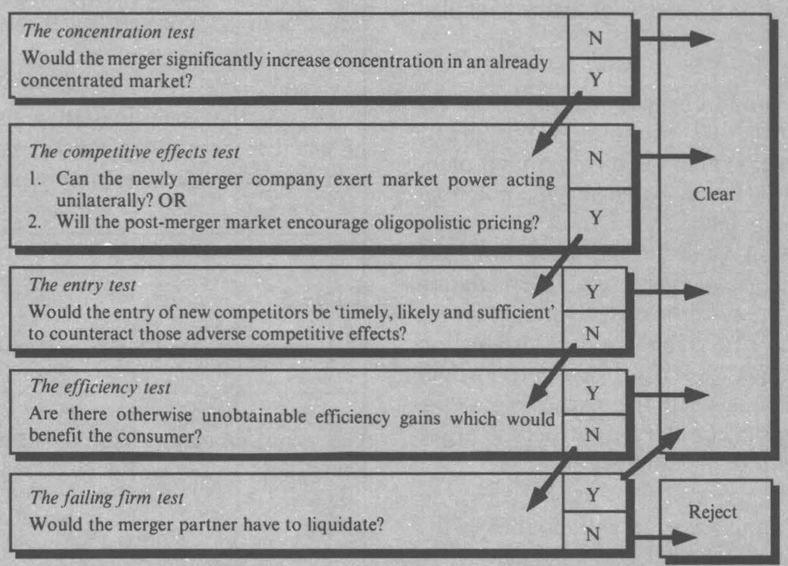
The competitive effects test

4.1.6. It is here that questions about the risk of oligopolistic dominance arising as a result of a merger explicitly enter the equation. For the first time the new guidelines explicitly pose the question: will the post-merger market encourage oligopoly pricing? They do so by demanding an examination of the potential for profitable distortion through 'coordinated interaction'.

4.1.7. A merger will fail because of possibilities for 'coordinated interaction' if hypothetical collusion in the relevant market, post-merger, would be profitable and viable. If competitors in the post-merger market-place can reach an understanding (tacit or explicit), and detect those who breach the understanding and punish them, the merger will be opposed. 'Reaching an understanding' includes being able to set a common price, set fixed price differentials, preserve

[1] The relevant market is determined by the 5% rule already referred to in our discussion of contestability. This issue is examined in detail by Professor Sleuwaegen in his paper 'The relevant antitrust market' in this volume.

GRAPH 2: **The 1991 US merger guidelines — A five-step process**



market shares or divide customers into territories. The government does not have the burden of showing that possibilities for coordinated interaction are a direct consequence of the merger. A merger can be opposed simply if these possibilities exist.

4.1.8. At the same time, the guidelines recognize that for any given level of concentration, some market environments will be much more amenable to coordinated interaction than others as suggested by the coordination school. Specifically, they allow for consideration of:

(i) the greater difficulty which suppliers that are isolated or different from one and other may find in reaching an understanding. Product heterogeneity and supplier diversity arguments can enter here. Past collusion, however, is considered evidence that future coordinated interaction is possible;

(ii) whether detailed current information about specific transactions or standard prices are publicly available, making price cuts in breach of a collusive understanding easily detectable. This takes account, for example, of the fact that in markets where sales are few and negotiated privately, the rewards for cheating often outweigh the sanctions by competitors. It is essentially a test of whether or not cheating can be detected;

(iii) the existence of what might be termed 'maverick competitors' — firms with special incentives to cut prices, such as those with excess capacity and available distribution channels, those with unusual ability to expand sales with secretly lower prices, or vertically integrated firms with more to lose from restrictions on output. Again this adopts the 'supplier diversity' argument of the coordination school.

The entry test

4.1.9. In cases where these considerations suggest that coordinated interaction is possible and hence a merger could be expected to increase the likelihood of distortions through oligopolistic collusion, it is still possible that the merger might be approved under US policy. The circumstances where approval would be forthcoming are as follows:

(i) where 'timely, likely and sufficient' entry of new competitors is likely to counteract the increased scope for oligopolistic collusion;

(ii) where otherwise unobtainable efficiency gains will accrue and be passed on to the consumer;

(iii) where one merger partner would have to liquidate its assets, destroying accumulated goodwill (or intangible assets such as organizational systems or teams of skilled staff).

4.1.10. The first of these conditions, ease of entry, has become more stringent under the 1991 proposals. To be timely, a potential competitor must be able to go from initial planning to market impact in two years. To be likely, a potential competitor must be able to enter the market on a cost-efficient scale of production while at the same time not depressing prices below the pre-merger levels. In calculating whether prices would be depressed below pre-merger levels, the guidelines assume that if a viable scale of production adds 5% to total pre-merger capacity, then entry would depress prices. The exception is where the market is growing rapidly, hence making it easier for merger partners to argue that entry will occur without depressing prices.

4.1.11. These conditions imply considerable doubts in the minds of policy-makers as to whether entry is likely to be an effective counterweight to increased potential for oligopolistic collusion. It effectively restricts the 'ease of entry' defence, often used by merger applicants in the past, to very special cases.

The efficiency test

4.1.12. The efficiency gains condition, which was introduced in 1984, has been retained in the new guidelines. It does not act as a direct defence against the increased likelihood of coordinated interaction because it would be difficult to demonstrate that the efficiency gains would be passed on in such cases.

The failing firm test

4.1.13. Finally, the failing firm condition, which may justify a merger if one firm would otherwise have to liquidate its position, has also become more restrictive. The new guidelines state that this defence cannot be used if the failing firm can be sold for just over its liquidation value. This means that if there is any chance of a firm remaining as a going concern under new ownership, thus preserving its intangible organizational capital (or goodwill), rather than being broken up for asset value, this route will be preferred rather than a merger with another firm.

4.1.14. In markets where a merger would substantially increase already high concentration, the 1991 US guidelines give significantly greater weight to the possibility of dominance arising from oligopolistic coordination than previously. Rather than simply asking whether the new firm could exercise market power by acting alone, it now explicitly examines whether the conditions would exist for a group of large firms to raise prices through effective tacit coordination.

4.1.15. At the same time, they also allow for consideration of whether or not the market is contestable and whether other market characteristics such as firm diversity, lack of

Table 3

Major changes to the US merger guidelines in 1991

The concentration test	'Uncommitted competitors', i.e. those for whom 'hit and run' entry would be profitable based on minimal sunk costs, can now be included as if they were already operating in the market for the purposes of calculating concentration (HHI). Thus mergers in highly contestable markets are now more likely to be cleared.
The competitive effects	A test for oligopolistic dominance based on a test of 'coordinated action' by a group of suppliers has now been explicitly introduced in addition to a test of single firm dominance. However, it is also explicitly recognized that coordination may be much less likely in markets with heterogeneous products, where pricing policies reduce transparency and where there are 'maverick competitors'.
The entry test	This has been substantially tightened to increase the burden of proof for a defence based on entry. Entry must now be timely (sales within two years) and likely — in the sense that an efficient scale supplier could enter without depressing prices to a level which would make the entrant unprofitable.
The efficiency test	No change, but, as before, clearance on efficiency grounds requires that the benefits will be passed on to consumers (difficult to show under oligopolistic dominance).
The failing firm test	The new guidelines restrict the use of the defence that one of the parties will fail without the merger. To be accepted as a basis for clearance it is now necessary to show that the firm cannot be sold to a disinterested party for any price above its liquidation value.

information on pricing, etc. will act to hamper effective coordination even when concentration is high. The guidelines also allow for the threat of entry to be considered as a possible factor upsetting oligopolistic dominance, albeit under very stringent tests of the reality of this threat. Table 3 summarizes the main changes to the US merger guidelines in 1991.

4.1.16. Although the US merger guidelines are obviously highly developed and tend to be much more explicit compared with legislation in most European countries, they do not cover all the aspects suggested by theory and empirical evidence. In particular:

(i) no account is taken of the potential impact of multimarket contact;

(ii) the regulations assume that high levels of concentration are always a necessary condition for potential loss of public interest;

(iii) the US guidelines are not specific about how they trade and import competition will be handled;

(iv) they take no account of oligopolistic dominance arising from barriers to intra-industry mobility and associated strategic groups. Instead, they attempt to handle this case by a combination of narrow definitions of the relevant market where necessary and by setting quite a low concentration threshold for almost certain clearance of mergers without further investigation;

(v) finally, although the guidelines admit the fact that some market environments are much more conducive to coordination than others, they in fact consider relatively few of the potentially relevant characteristics in deciding whether sustained coordination is likely to be viable.

4.2. United Kingdom

4.2.1. Despite the fact that the 1973 UK Fair Trading Act which regulates mergers is essentially benevolent towards them, it is broad-reaching in the way it chooses to define mergers which the Office of Fair Trading is required to examine. A qualifying merger (that which must be examined) includes:

(i) any merger in which the gross assets being taken over exceed a value of UKL 30 million (this threshold is changed from time to time, but was last set in 1984);

(ii) any merger, regardless of size, where the merged companies would together control at least 25% of the UK market for one of the products or services they both supply;

(iii) any merger, regardless of size, which may give rise to a complex monopoly. A complex monopoly is defined as a situation where at least 25% of the UK market for a particular good or service is supplied by a group of two or more firms which are not connected (e.g. by ownership) but 'who, whether voluntarily or not and whether by agreement or not, so conduct their respective affairs as in any way to prevent, restrict, or distort competition in connection with production or supply'.

4.2.2. As will be evident, the complex monopoly criterion amounts to a definition of a duopoly or oligopoly being able to distort competition for at least 25% of the UK market for a product or service.

4.2.3. All mergers falling into these categories are then screened by the Office of Fair Trading (OFT) which advises as to whether the merger should be investigated in detail by the Monopolies and Mergers Commission (MMC) or instead cleared without further analysis. The Act states that the decision as to whether to clear a merger or refer it to the MMC should be taken on the basis of 'whether the merger may be expected to operate against the public interest'. The director of the OFT is given wide discretion as to how this should be interpreted. The current director has indicated that beyond considering the joint market share of the post-merger enterprise, he also considers:

'factors which indicate that, although a merger will bring about high market share, it cannot in fact confer market power or lend itself to abuse. ... I look at competition — and potential competition — from imports as part of my examination of how far the market is "contestable". In the same way, I will consider arguments that falling demand, overcapacity, or buyer power will constrain a monopolist' (Borrie (1989), p. 254).

4.2.4. If a merger is referred to the MMC, they are asked to make a detailed analysis of 'whether the merger may be expected to operate against the public interest'. The legislation charges the MMC to consider 'all relevant matters' and gives only very broad indications as to what these should be such as 'the maintenance or promotion of effective competition'.

4.2.5. The UK policy is therefore strongly of the view that market power by a single firm or a group of firms involves complex and specific judgments which can only be made on a case-by-case basis. It does not publish any guidelines for the way its recommendations will be reached, although the logic on which its conclusions are based is always detailed in a public report on each case. By examining these case histories, we can discern various guidelines which the MMC has adopted in practice. These may be briefly summarized as follows:

(i) Market definition involves both a product and a geographic dimension. The product market definition is reached by looking for a gap in the chain of substitutes. The geographic dimension involves considering how competition is localized by transport costs or the immobility of goods and services produced.

(ii) The MMC has taken a very flexible approach to the use of concentration as an indicator of market power. Broadly, mergers where combined market share is less than 30% are likely to be allowed. Those where the combined share is over 60% are likely to be prevented. Inside this range the MMC considers many other factors along with concentration. Interestingly, in the case of quality malt whisky, the MMC recommended against the merger despite relatively low concentration, as discussed below.

(iii) The potential for new entry has played an important role in MMC decisions, especially where the post-merger market shares are high. However, the MMC has tended to place a low weight on the threat of entry where construction of new plants is required. It has been persuaded by the entry argument mainly when the necessary assets already exist and only need to be re-allocated between markets as in the cases of Trafalgar House/P&O (passenger cruises by ship), P&O/European Ferries (freight ferry services), McCorquodale/Norton Opax (personalized cheque printing).

(iv) Buyer power — based on buyer concentration and the costs involved in switching between suppliers — has also figured prominently in MMC decisions. The argument that buyer concentration will offset the effects of high supplier concentration has generally been rejected where the product is highly specialized or made-to-order, on the argument that switching suppliers would involve the buyer in substantial costs. These costs would provide a price umbrella for exploitation of dominance.

(v) Actual and potential competition from imports and global market shares, post-merger, have also been given considerable weight.

(vi) Finally, the average capacity utilization in the industry, barriers to exit and capacity indivisibilities have been taken into account in assessing the likelihood of effective market dominance by a single firm or group of firms, as the coordination school would suggest.

4.2.5. Compared with the US guidelines, however, the UK MMC has placed considerably less reliance on imputing future market performance solely from structural indicators. Conversely, the use of past conduct as a guide to the future performance of a market, post-merger, at any level of concentration has played a much greater role than in the USA. Specifically, the MMC has considered the following indicators of past conduct and performance in recent merger cases:

(i) geographic variations in prices,

(ii) serial correlation in past price movements by large firms,

(iii) frequency with which customers have changed suppliers in the past,

(iv) whether leading competitors have been losing or gaining share,

(v) historic profitability levels.

4.2.6. In cases where oligopolistic dominance may arise, the MMC has also implicitly taken into account the possibility of coordination within a tight strategic group, even where overall industry concentration was moderate. In the merger case of Hiram Walker/Highland Distillers which was disallowed, the MMC examined scope for market power to arise within a group of quality malt whisky distilleries. In computing concentration and examining scope for coordination it excluded distilleries which produced a lower-quality product and those owned by a large company, Distillers Limited, because it was considered to be self-sufficient in malts and was not set up to sell to the same types of customers even though it had a suitable product available.

4.2.7. Although not directly a merger case, these considerations also played a role in its report on the supply of beer which, finding against a group of large brewers stated (MMC (1989), p. 264):

'We do not deny that there is competition between the brewers but we consider that the practices set out in the complex monopoly have led to a muted and stylized form of competition. In particular, most brewers, and certainly all of the nationals, are pursuing the same strategy at the retail level of high price and high amenity. We think it important that it should be possible for independent retailers to challenge this strategy and test whether it is what the consumer really wants.'

4.3. Germany

4.3.1. The German Act against restraint of trade (ARC) explicitly recognizes the potential for adverse welfare effects arising from oligopolistic market dominance. This is reflected in a legal requirement for the investigation of mergers where the post-merger market structure would be such that three or fewer enterprises have a combined market share of 50% or more, or when five or less firms have a combined market share of 67% or more. In this case, domination is not presumed where combined turnovers do not exceed DM 100 million.

4.3.2. The Federal Cartel Office (FCO) acts as investigator and adjudicator in upholding this law. Its decisions are then subject to judicial review by the Court of Appeal in Berlin. Following the adoption of regulations on the control of concentrations between undertakings by the Council of the European Communities in 1989, the FCO published a description of its enforcement policy in the form of a checklist of the factors used to examine whether a merger would create or strengthen a market-dominating position (FCO (1990)). The main features of this checklist, which took account of past decisions of the FCO and the courts as well as legal and economic debate, is summarized below.

4.3.3. The existence of oligopolistic market dominance for the purposes of merger control is based on an overall assessment of the conditions of competition (structural indicators) and the competitive process (conduct indicators). Where the merger may lead to a strengthening of oligopolistic dominance, the critical determination is whether competitive conditions can be expected to deteriorate further as a result. It is important to note, however, that this judgment is not based on forecasting future competitive conduct. It is sufficient that the merger is highly likely to create the structural conditions 'which facilitate or secure parallel behaviour' (FCO, op. cit., p. 57). In the case of a merger which may create oligopolistic dominance, the change in competitive conditions as a result of the merger must be such that substantial competition found (or imputed) before the merger will be highly likely to disappear post-merger given the new competitive conditions.

4.3.4. Under the heading of 'competitive conditions', the FCO checklist includes an examination of the following factors:

concentration of market share,

the development of market shares (market share stability),

the symmetry of the oligopoly (equality of market shares),

interlocks (via interlocking directorates or capital links),

barriers to entry,

competition from imperfect substitutes,

foreign competitors,

buying power of customers,

market phase (growth, maturity, etc.).

4.3.5. The use of information on market share stability is of particular interest. The FCO's discussion of the checklist described the use of this indicator as follows (FCO, op. cit., p. 58):

'The development of the market shares of oligopolists over time may also provide meaningful information about competitive processes. Stable or relatively stable market shares or differences between the oligopolists' shares point to an uncompetitive oligopoly. This is true, in particular, if the market shares have remained stable despite significant changes in external market circumstances, such as a substantial drop in demand. ... However, if market shares are so unstable that the firms hold different ranks with every new period, it can be assumed that there is a competitive oligopoly. Short-term fluctuations in market shares (two to four periods) in principle are more meaningful than are long-term fluctuations. The former point to active competitive conduct, whereas the latter are more likely to result from structural changes in market conditions such as a change in buyer preferences (Morris-Rothmans). However, the causes of the market share fluctuations also have to be considered. If they merely result from interbrand advertising competition without quality competition also being present, even market share fluctuations will give no indication of the presence of substantial competition.'

4.3.6. Another interesting feature of the FCO's approach is the explicit consideration of 'symmetry of the oligopoly' (FCO, op. cit., p. 59):

'The more equal the firm-related structural features of the firms belonging to an oligopoly are, the greater the likelihood of conscious parallelism will be. ... Asymmetry of an oligopoly, on the other hand, is not itself a sufficient indication of substantial competition among the oligopolists, but asymmetrical oligopolies have a greater potential for individual competitive conduct. ... Mergers that lead to firms in the oligopoly becoming structurally similar encourage parallel behaviour. In principle, this applies to vertical and conglomerate mergers as well as to horizontal mergers.'

4.3.7. It is often the case that consideration of this bundle of structural indicators of competitive conditions will lead to some conflicting signals: some suggesting the likelihood of oligopolistic dominance, while others would cause us to question how likely it would be to arise. An overall appraisal of the indicators in concert is therefore undertaken. The central criteria in this assessment, however, are market share and barriers to entry (FCO, op. cit., p. 62).

4.3.8. The competitive process is also analysed (although this analysis need not be completed if the structural indicators suggest that dominance is unlikely). This analysis is based on a series of conduct indicators which reflect the actual behaviour of the market participants, pre-merger. These include pricing and discounting systems which influence the degree of market transparency, uniformity of pricing by the oligopolists, etc.

4.3.9. Consideration of the structural and conduct measures is complementary. The aim of considering conduct is to determine whether or not there is clear evidence of substantial, workable competition existing in the market. If there is no such evidence, a market-dominating oligopoly is assumed to exist provided that the structural indicators confirm this or 'at least are not in conflict with it'. If, on the other hand, substantial competition is found to exist in the market, premerger, the merger could be cleared, but only if there were good reasons to expect it would persist in the future in spite of the change in market structure resulting from the merger.

4.4. France

4.4.1. In 1977 the French Government passed a law on the control of economic concentration and the abuses of dominant positions, along with other restrictive trade practices. The law is implemented through the Directorate-General for Competition (DGC) which carries out an initial investigation and may refer the case to the Competition Council which recommends action to a government minister. The provisions which are relevant to mergers in the context of oligopolistic dominance prohibit a merger when it would enable 'one enterprise or a group of enterprises to exercise influence, directly or indirectly, on one or more other enterprises which is of such a nature as to direct or even orientate the management of working of the latter'.

4.4.2. The DGC examines mergers which exceed certain size thresholds based on turnover and where the merger brings about a combined market share exceeding 25% of the relevant market. In parallel with the UK policy, the French Competition Council adopts a case-by-case approach. It is required to advise the minister on 'whether a merger or proposed merger would make a sufficiently significant contribution to economic progress to compensate for the restraint of competition'. This first involves deciding on the probability that a restraint on competition (either through single firm action of oligopolistic interaction) will arise. A wide variety of factors are taken into account here beyond concentration, as suggested by the coordination school, once a definition of the relevant market has been agreed. The second stage involves deciding on the 'contribution to economic progress'. In practice, this tends to be dominated by a decision as to whether the larger merged firm will be better able to compete in international markets. This defence against high concentration has been accepted in a significant number of cases.

4.4.3. If a merger is found to be unacceptable on these grounds, the minister can still allow the merger to proceed on a wide range of bases including 'taking measures to ensure that an adequate degree of competition exists or requiring the merging parties to make a contribution to social or economic welfare in some other way'.

4.5. Italy

4.5.1. The Italian Competition Authority must be notified of mergers where aggregate sales in Italy of all enterprises involved exceed LIT 500 billion or where the target company's sales exceed LIT 50 billion. The legislation sets a very tight time-scale for the authority to operate under: it has 30 days to open proceedings and only 45 days later it must submit a report to the minister. This does not allow for complex analysis of a wide variety of structure and conduct characteristics of the type often considered in, for example, the UK (which may take a maximum of six months).

4.5.2. The act which established the Italian Competition Authority requires it to recommend clearance or opposition to a merger on the grounds of its effects on competition. It does not, however, define a clear set of guidelines as to how these competition effects should be evaluated. To date, there has been an insufficient body of case evidence to impute the weightings given to various structure and conduct measures by the Italian Competition Authority.

4.6. Some general comparisons between national approaches

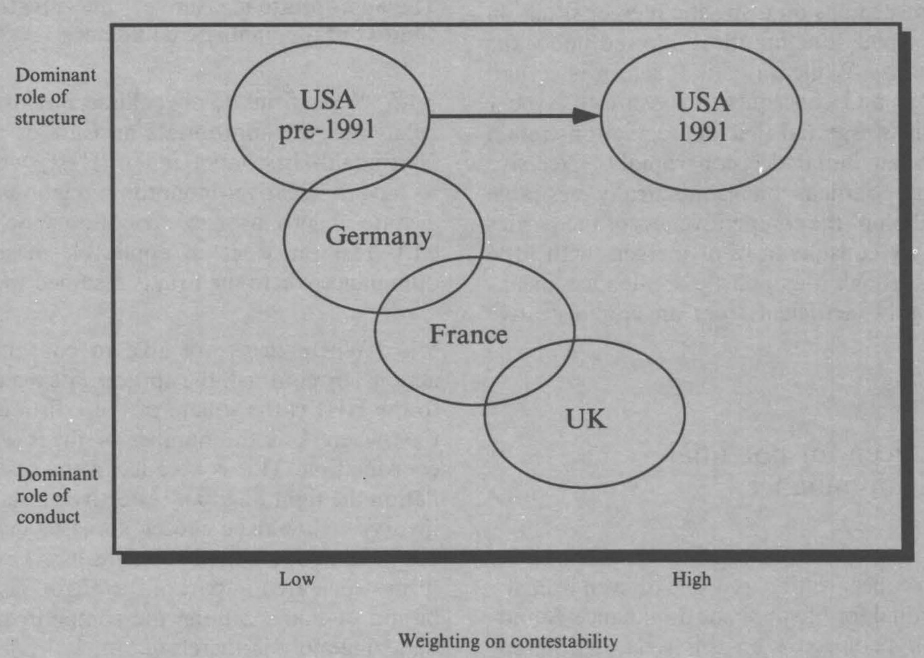
4.6.1. Attempts to reduce the richness of different national approaches to the control of oligopolistic dominance are fraught with difficulty, especially given the importance of complex case precedents in a number of countries. With that caveat, however, it is perhaps useful to characterize the broad differences in approach in terms of the differing weights given to structure versus conduct variables and the importance given to market contestability as in Graph 3 (below).[1]

[1] This matrix was kindly suggested by the commentator on an earlier version of this paper.

4.6.2. While each of the national merger control systems studied considers the general issue of entry conditions, the 1991 US guidelines go considerably further in bringing consideration of market contestability and associated sunk costs explicitly into case assessment in a very precise way. The implications of potential import competition for market contestability and its potential impact on oligopolistic dominance, however, are not considered separately in the US guidelines. In Europe, by contrast, it has been common to consider competition from import suppliers, but the means by which it enters the assessment is seldom specifically specified. Given the increasing importance of trade on the effective level of contestability in many markets, we will return to this issue in Section 5.

4.6.3. A second general dimension along which national systems differ is the relative weight given to indicators of market structure versus indicators of past market conduct. All of the systems examined to some degree impute the impact of a merger on the probability of likely future anti-competitive behaviour from its expected impact on the structure of the market in question. There are, however, significant differences in the degree of attention given to past conduct in assessing how susceptible the industry is to conduct which would help create and maintain oligopolistic dominance. The US guidelines give relatively least weight to past conduct, relying most heavily on the presumption of a tight link between market structure, conduct and performance. Under the FCO in Germany, both structure and past conduct are considered, but relatively more weight is given to 'conditions of competition' (structural variables). On the basis of the case-by-case considerations published by the Monopolies and Mergers Commission in the UK, it would appear that market conduct indicators generally play a more important role than elsewhere.

GRAPH 3: **Broad comparisons of national approaches**



5. Towards an EC policy for merger control based on indicators of oligopolistic dominance

(a) In order to stimulate further discussion of a practical merger policy which utilizes indicators of oligopolistic dominance, this section outlines one set of proposals for future guidelines in the EC context. It draws heavily on the two previous sections covering theory and existing national policies. Our concern here, however, is to consider how these concepts may be translated into workable indicators and policy tests.

(b) The basic decision-making framework is outlined in Graph 4. This begins with a relatively simple initial screen for whether there are grounds for further investigation of the potential for oligopolistic dominance. Two possibilities are proposed here: a joint test based on concentration and past stability of market shares, and an alternative approach based on a single concentration test but where the concentration index has been adjusted to make allowance for differences in contestability and strategic group structure between markets. For mergers which create a significant risk of increasing the welfare loss through oligopolistic dominance, as determined by this screen, the suggestion is that five further tests be applied sequentially. These are: the coordinated action test, the trade exposure test, the contestability test, the efficiency test and the failing firm test.

(c) An important reason for designing an initial screen is the need for a process which can deliver a decision whether or not to initiate proceedings on a specific merger situation within a short time-frame (one month is allowed under the current EC regulations). While any initial screen is certain to have imperfections and consequent exposure to 'type 1 and type 2 errors', it is essential that the regulations retain the ability to reach an initial decision rapidly. Excessive delays would impose burdens on economically desirable mergers which could blunt the competitiveness of the parties involved. Unnecessary consideration of mergers with little risk of welfare loss through oligopolistic dominance, meanwhile, would be highly inefficient from an administrative point of view.

5.1. An initial screen for potential oligopolistic dominance

5.1.1. Earlier in this paper we discussed the problems with excessive reliance on concentration as a sole or even primary indicator of the potential for oligopolistic dominance. Standing in the 1990s our perspective on this issue is different from 20 or even 10 years ago given the mounting empirical evidence that the concentration-profitability relationship is much more complex than previously thought. We also noted that in a world where product-service bundles are becoming more complex and hence the offerings of different firms more heterogeneous, scope for effective oligopolistic dominance between small, strategic groups of firms is becoming more likely, even where measured industry concentration is only moderate.

5.1.2. Two possible approaches to overcoming the limitations of standard concentration measures are suggested below. The first involves the use of post-merger concentration (based on market share) and the degree of past market share stability as a joint initial screen. The alternative centres on adjusting the definition of the market and the concentration index.

5.1.3. Following the classification outlined in Graph 1, the initial screen jointly based on two tests — concentration and market stability — is illustrated in Graph 5 below.

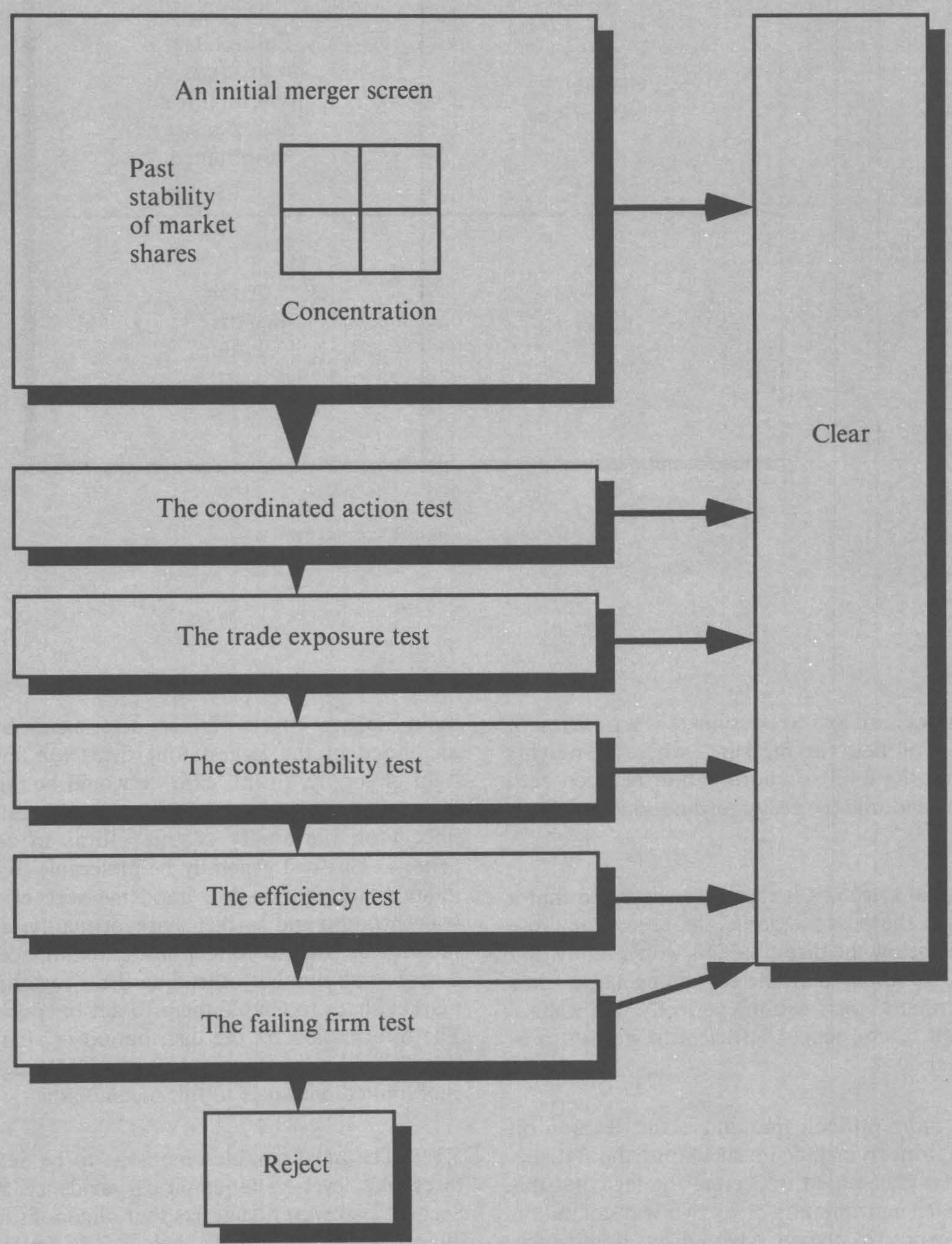
5.1.4. In the case where both indicators are in the low range, no further investigation of oligopolistic dominance would be undertaken. Where both indicators were in the high range a full investigation would need to be carried out. Where the indicators gave conflicting signals, we have suggested some other simple tests which might be applied in order to decide whether further investigation was warranted.

The appropriate measure of concentration in the context of oligopolistic dominance

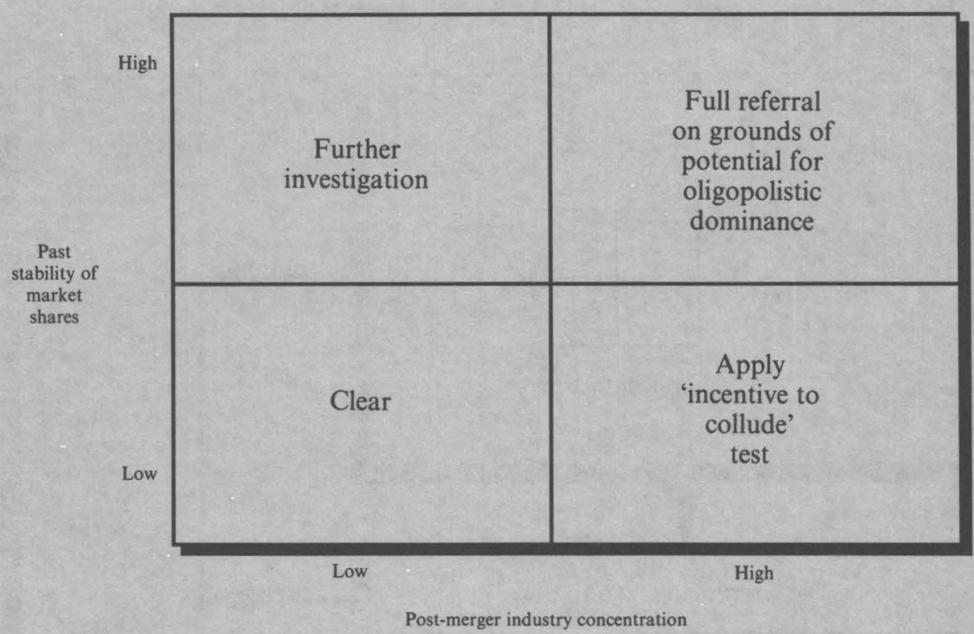
5.1.5. When firms do not collude, but instead adopt Cournot behaviour, the appropriate measure of concentration is the Herfindahl-Hirschman index (HHI) which can be shown to have a negative, monotonic relationship with consumer welfare under reasonable conditions (Scherer and Ross, op. cit.). This makes it an applicable measure of single firm dominance where the firm is assumed to act unilaterally.

5.1.6. Where firms are able to coordinate perfectly their actions, by contrast, the appropriate measure corresponding to the HHI is the square of the k-firm concentration ratio, C_k^2, where k is the number of firms who are involved in coordination. This is because in the case of perfect coordination the tight oligopoly effectively acts as a single firm. In theory, k should be chosen so as to include all firms who act in a tightly coordinated fashion, excluding the fringe firms which are not part of the oligopolistic core. The distribution of shares among the competitive fringe outside the tight oligopoly is therefore largely irrelevant to the size of the welfare loss. In the case of partial coordination, it can

GRAPH 4: **A decision-making framework for mergers and oligopolistic dominance**



GRAPH 5: **An initial merger screen**



be shown that the welfare loss to consumers is a function of a weighted average of these two measures, where the weights are determined by the level of coordination between zero (no coordination) and one (perfect coordination) (see Sleuwaegen, op. cit.).

5.1.7. For the initial screen, it is therefore suggested that a threshold based on the post-merger C_k be used. For those mergers which fell below the threshold this would imply that even in the unlikely event that the remaining large firms were able to coordinate their actions perfectly, the welfare loss would still not be considered sufficient to warrant prohibiting the merger.

5.1.8. Perhaps a more difficult question is the decision on k, the number of firms to include in calculating the statistic. It is suggested that C_4 be used, reflecting the fact that this already requires tacit coordination of six two-way communication flows in order to sustain oligopolistic dominance. Basing the initial screen for oligopolistic dominance on C_5 or C_6 would imply that 10 two-way flows and 15 two-way flows of information were commonly a viable basis for tacit collusion. If we chose C_4 this amounts to assuming that the main welfare effects can be determined by deciding the likelihood of the largest four firms (or fewer) forming a tight oligopoly. In this case we would be implying that the distribution of shares outside the four largest firms has little impact on the ability of these firms to coordinate their actions. This will generally be preferable to using the HHI index which, although a good measure of overall market concentration and market share inequality, is likely to cloud the central issue for oligopolistic dominance; namely: does a very small number of leading firms together have enough market share to enable them to act in concert as a group? The information on the distribution of shares outside this handful of leading firms which the HHI takes into account is of limited relevance to this second issue.

5.1.9. The most troublesome issue to be determined is the threshold level. The empirical evidence referred to in Section 2, however, suggests that oligopolistic dominance is almost never viable at C_4 below 50% unless it is possible for suppliers to form protected strategic groups within the industry (for which a separate test is suggested). Thus a threshold of post-merger $C_4 < 50\%$ for clearance on the concentration test could be adopted.

5.1.10. Alternatively, following the pattern of the US legislation, three threshold ranges could be adopted:

(i) a threshold below which a merger would be cleared (e.g. $C_4 < 40\%$);

(ii) a grey area (e.g. $40\% < C_4 < 60\%$);

(iii) a high-risk threshold (e.g. $C_4 > 60\%$).

Such a gradation, however, is not recommended for a number of reasons. First, it would imply a tighter relationship between concentration and market performance than is consistent with the findings of the large body of empirical evidence (referred to previously) which suggests a rather imperfect correlation. Recall that the prime conclusion of these studies is that below some concentration levels, oligopolistic dominance is unlikely to arise. Above this level the probability of oligopolistic dominance depends on many factors operating in concert. It is far from clear that an industry with C_4 at (say) 65% is systematically less likely to exhibit the conditions for oligopolistic dominance than an industry with C_4 at 70% or even 75%. Second, it is not clear how the policy should treat a merger causing concentration to fall into a 'grey area' differently from one pushing concentration into a zone classified as high risk. Given the empirically loose, positive relationship between concentration and the risk of oligopolistic dominance above the threshold level of concentration, it can be argued that all mergers which would push concentration above the low-risk range should be subject to further investigation.

5.1.11. Against this background, it is also worth addressing the issue of what weight should be given to the size of the increase in concentration in determining whether or not a merger should be further investigated. Again it is far from clear that we should be more concerned with a merger that takes concentration from (say) 65 to 75% than one which would move it from 65 to 70%, despite the fact that increase in concentration is twice as large.

5.1.12. In principle what we are interested in are mergers which take an industry from a level of concentration where oligopolistic dominance is unlikely to be feasible into the range where the concentration level is sufficient to provide a basis for oligopolistic dominance should other conditions also promote it (i.e. we should be most concerned with mergers which push an industry decisively beyond the threshold for actions on the basis of recognition of mutual dependence. Therefore large increases in concentration, *per se,* are not a problem. We would hardly be concerned, for example, with a merger that increases concentration (C_4) from 10 to 40% from an oligopolistic dominance standpoint, despite the 30 percentage-point increase in the concentration indicator.

5.1.13. At the same time we must bear in mind that there is a broad empirical relationship between concentration and welfare loss above the low concentration range. Therefore we should generally be more concerned with those mergers that generate a large increase in concentration wherever the level of post-merger concentration would be above the low-risk range.

5.1.14. From a practical policy standpoint, then the recommendation would be to set a single low-risk concentration threshold below which mergers would be cleared and to pay particular attention to mergers generating large increases in concentration in the subsequent consideration of those not automatically cleared.

The market stability test

5.1.15. The stability of market shares provides a general indicator of a possible oligopolistic bargain as Caves and Porter (1978) note:

'The instability of market shares, especially among an industry's leading firms, provides a measurable indicator of rival behaviour in oligopolistic markets. The stability of shares reflects the stability and completeness of the oligopolistic bargain, as well as the size and nature of exogenous disturbances to that bargain.'

5.1.16. In the context of merger policy this measure would alert us to the presence of an existing structure and history of past conduct conducive to oligopolistic coordination. Under these conditions mergers would be of concern because of their potential to increase the sustainability of an industry-wide oligopolistic bargain.

5.1.17. Traditionally, the conditions giving rise to an oligopolistic bargain of the type indicated by stability of market shares have been those emphasized by the coordination school. The concept is of a group of oligopolists able to coordinate changes in their prices (possibly by judicious use of inventories to adjust sales so as to maintain a supra-competitive price). Other tests, such as price parallelism or inventory behaviour, could potentially also signal the existence of such a bargain.

5.1.18. Let us deal first with alternative measures of coordination directly based on conduct. In practice, these are very difficult to implement satisfactorily. Inventory patterns, for example, while a sound measure in the theoretical world of instantaneous, price-clearing markets, are difficult to interpret using real-world data where transactions costs and lot-size economies mean that most firms deploy inventories to smooth out short-term demand shifts even in competitive markets. Price parallelism as a measure has greater potential for implementation (it has been utilized by the Monopolies and Mergers Commission in the UK in a number of cases, for example, as discussed in Section 4). However, price parallelism suffers from the problem that prices would move together when the costs of all producers rose or fell, even in a perfectly competitive market. It is therefore difficult to disentangle anti-competitive behaviour from the common response of competitive firms to exogeneous disturbances. Analogous issues also arise in respect of market share stability measures, as we note below. Yet there are reasons to believe that the dangers of market share stability masking vigorous price competition are less than the risks of price parallelism erroneously suggesting collusion.

5.1.19. However, there is perhaps an even more fundamental reason for suggesting a role for market share stability as a primary test of the risk of oligopolistic dominance. This stems from the possibility that in looking for signs of continuous coordination of pricing actions as the means of maintaining oligopolistic dominance we may be asking the wrong question. Instead, intending oligopolists may simply tacitly agree to divide up the market into relatively distinct customer-product segments, each focusing on a different set to their competitors. Having reached this understanding, coordination on prices, products, inventories, marketing, etc. will no longer be necessary to maintain an oligopoly with muted competition. Indeed, it may be precisely because such coordination is difficult that the oligopolists choose the divide and rule strategy. Over time, sunk-cost investments in this kind of specialization will be likely to reduce the contestability of each leading firm's position, reducing the likelihood that the initial taut agreement will fall apart through competition on the fringes of each 'duchy'.

5.1.20. As noted in Section 3, this process is likely to be important in Europe as national champions seek to maintain their protected competitive environments under threat from the completion of the single market. Mergers and acquisitions may play an important role in strengthening non-competing, non-contestable strategic groups in two main ways:

(i) by allowing the threat of a potentially destabilizing member of a strategic group to be removed through takeover;

(ii) by acquiring a potential new entrant into a strategic group in the form of a firm with the capabilities to move between strategic groups.

5.1.21. EC merger policy may take the view that the appropriate way of dealing with the risks of this behaviour is to define the market narrowly so as to separate out each strategic group. A merger involving any one would then be examined under the provisions of single firm dominance. There are, however, two sets of problems with this approach.

5.1.22. First, a policy approach based on narrow market definitions does not deal with the problems of maintenance of oligopolistic dominance through a firm acquiring a potential entrant to its strategic group. Under narrow market definition, such an acquisition would involve purchase of a firm in a second market. While it may have an important role in maintaining an oligopolistic bargain, therefore, it would not fall foul of the tests of single firm dominance in narrowly defined markets. Only if these narrow markets were treated as a set of related markets could such a case be properly examined.

5.1.23. Second, customer-product segments and associated strategic groups are notoriously difficult to distinguish by direct empiricism. In complex products they are defined by multi-attribute product-service bundles which depend on differences in the marketing capabilities, distribution power, service competences and other intangible assets and information accumulated by particular firms. The substitutability of different suppliers' offerings and associated switching costs are often poorly understood by customers. Indeed, these information imperfections are often an important reason for the strategic group segmentation to be maintained. To separate clearly the strategic groups and customer segments into discrete markets would, therefore, present formidable practical problems for the implementation of merger policy. Since many of the judgments required would necessarily be subjective, justification may prove difficult.

5.1.24. Obviously there is no simple solution to these issues. One proposal, however, is to use an index of the past stability of market shares as an indicator. The susceptibility of the market to oligopolistic dominance based on either:

(i) oligopolistic coordination of pricing; and/or

(ii) tacit agreement to mute competition through the formation of a structure of non-competing, non-contestable strategic groups.

5.1.25. In this case mergers which increased the ability of oligopolists to coordinate pricing or strengthened the strategic group structure would risk welfare losses.

Our first proposal for the initial merger screening for potential oligopolistic dominance therefore includes:

(i) a structural indicator: the concentration index;

(ii) an indicator of past conduct (pricing coordination or strategic group behaviour); the stability of market shares.

Failure on either of these tests would constitute grounds for further investigation.

5.1.26. Before proceeding, let us deal with possible bias in any measure of share stability as a result of different levels of exogenous disturbance across industries. It is true that such an indicator fails to distinguish between competition and exogenous disturbances as sources of market share instability. By using a measure of market share stability as a joint initial screen, therefore, it may be that we incorrectly clear some mergers where underlying oligopolistic coordination is disguised by high exogenous disturbance. But this is unlikely to be a severe problem for three reasons. First, it will be difficult to sustain oligopolistic coordination in the face of large external shocks. Second, it is unlikely that coordination on price would continue to survive the pressures to abandon the tacit bargain by those firms losing significant share — a situation which will often be associated with overall share instability. Third, sustainable coordination in the face of large external shocks is more probable when concentration is also high, so that some of these cases would be identified by the joint concentration test.

5.1.27. Consider the situation where we find that market shares are highly stable. This may be because there have been very low levels of exogenous disturbance, rather than signalling a lack of competition. However, we must also recognize that successful coordination is more likely, other things being equal, when it is not threatened by large exogenous disturbances. An initial screen which is biased towards selecting industries with low external disturbance levels for further investigation is therefore not necessarily a bad thing. Of course we may still wrongly identify some situations where market share stability is low and collusion does not exist. In this case, however, subsequent investigation should identify this fact and clear the merger. Moreover, Caves and Porter (op. cit., 1978) find considerable empirical validity in the use of market share stability as an indicator of oligopolistic dominance.

5.1.28. The next issue to be addressed is how should market share stability be measured. A number of different measures have been proposed by different investigators (see Gort (1963), Heggestad and Rhoades (1974), and Ogur (1976)). Given the objective of identifying an environment conducive to oligopolistic coordination, considerations of practical implementation, and consistency with the proposed concentration indicators, the suggested measure is Caves and Porter's 'relative share instability' (RSI) measure which is defined as:

$$RSI = \Sigma_i \Sigma_t (|S_{it} - S_{it-1}|)/S_{it-1}$$

where i is the index of firms and t is time, | denotes the absolute value, and S denotes a share of the market computed on the basis of volume.

5.1.29. It is suggested that the RSI measure be based on the four leading firms measured over the three preceding years. By using the four leading firms we would be implying that the strategic group structure involved:

(i) the four leading firms colluding in a single strategic group; or

(ii) each of these four firms enjoying its own sphere of influence over a group of customers with similar preferences; or

(iii) some combination of both.

5.1.30. We could, of course, add more firms into the computation in a straightforward manner. If, however, we found stability among the top five or six firms' market shares then we would almost certainly have already discovered it among the leading four.

5.1.31. Caves and Porter (op. cit., 1978) found a mean for RSI of 0,115 across a sample of 470 manufacturing businesses and their markets, with a standard deviation of 0,140. Interestingly, they found that stability tended to rise with concentration and advertising intensity and fall with R&D intensity. The correlation between RSI and concentration, however, was far from perfect, suggesting that the market share instability index adds significant new information about the characteristics of a market. Clearly, appropriate benchmark numbers would have to be computed for EC markets in order to set a threshold to divide high and low market share stability in Graph 5.

High concentration, unstable market shares

5.1.32. As we have seen, concentration is by no means a sufficient condition for oligopolistic dominance. At the same time, the market share stability test suffers from the deficiency that it imputes future behaviour from past industry conduct. Where the two indicators disagree — concentration, suggesting the need for concern, and unstable market shares, suggesting that the market has been vigorously competitive — then a measure of the impact of the merger on incentive to collude in the future could be applied.

5.1.33. Such an 'incentive to collude' test would utilize the fact that, as already noted, C_4^2 is proportional to profitability under perfect collusion while the HHI reflects the profitability of an industry in the absence of collusion (Cournot behaviour). By looking at the impact of a merger on the difference between these two measures, we could therefore construct an index of its impact on incentive to collude. Specifically:

$$\Delta ITC = (C_{4A}{}^2 - HHI_A) - (C_{4B}{}^2 - HHI_B)$$

5.1.34. Where ΔITC denotes the increase in incentive to collude, index A denotes the concentration measure after the proposed merger and index B the measure before the merger.

5.1.35. In practice, this index measures the extent to which mergers would equalize the shares of the four largest firms and hence encourage collusion rather than unilateral action. A simple example serves to illustrate. Suppose that the pre-merger market comprises five firms V,W,X,Y and Z, with the following percentage market shares, pre-merger:

	V	W	X	Y	Z
Pre-merger	20	20	20	10	10
Merger 1	30	20	20	10	
Merger 2	20	20	20	20	

5.1.36. Now consider two of the possible mergers shown: merger 1 where V buys Z and merger 2 where Y and Z combine. In both cases, C_4 would rise to 80%. In merger 1, however, there would be less incentive for the enlarged firm V to coordinate, because it could get relatively more of the potential gains by unilateral action. Moreover, Y may believe that it could gain share by cheating on any tacit agreement. Under merger 2, by contrast, which leaves four firms of equal size, the incentive to collude would be higher — each can see that starting from an equal base competition is more likely to lead to low prices than any real shifts in share. Consistent with this our ΔITC statistic is equal to 1 000 in the case of merger 1 and 1 200 in the case of merger 2.

Moderately low concentration and stable market shares

5.1.37. This may reflect the classic case where industry-wide coordination would be hampered by the need for tacit communication flows between too many firms for coordination to be successful, but where moderately low concentration can still be consistent with coordination based on division of the market into a number of strategic groups, each protected by barriers to mobility. There is, however, another possible explanation. With a very fragmented market it could be that firms actively compete on price, but ultimately this simply drives industry prices down without any individual firm gaining or losing any share. Chamberlin's (1962) 'monopolistic competition' model would exhibit such behaviour.

5.1.38. In practice, one has to doubt whether very stable market shares would often mask very vigorous price competition occurring below the surface. Empirically, Caves and Porter found high relative market share instability (RSI) at the lowest levels of concentration in their sample.

5.1.39. As with the high concentration/unstable market shares case, a second test would be applied where the concentration index and share stability gave different initial signals. This would take the form of examining a simple performance measure such as price-cost margins in the industry. Only if these were well below average might we be confident that it was vigorous price competition which was maintaining stable market shares. In any case, further investigation of the merger situation, as described below, should reveal any such unusual errors in the performance of the initial screening.

Adjusting a single concentration index: an alternative initial screen

5.1.40. Following the current US guidelines, a concentration index could be relied upon for the initial screening of mergers in place of the joint concentration/market share stability test. In order to overcome some of the limitations of the raw concentration indicator, certain refinements could be added. In particular:

(i) inclusion of theoretical, uncommitted competitors into the concentration index as if they were current participants in the market in the same way as the 1991 US guidelines. This amounts to an adjustment for the degree of contestability;

(ii) adopting a narrow definition of the market, to encompass a single strategic group, and computing the concentration index for oligopolistic dominance within this specialized market.

5.1.41. While there is no doubt this procedure would represent a viable alternative, there are a number of reasons why it has not been advanced as the primary proposal.

5.1.42. First, direct allowance for contestability via the inclusion of uncommitted competitors in the concentration index is a much more complex task than might first be apparent. It requires that a theoretical competitor be modelled in terms of revenue and cost position based on an assessment of the market share which could be supported from a base of minimal sunk costs. It could be argued that this kind of detailed, industry-specific analysis is more appropriate to a full merger investigation taking place after mergers have been selected by an initial screen. Indeed, it is uncertain whether a proper assessment of contestability could be undertaken on the current time-scale of one month maximum allowed for initial consideration of merger proposals in the EC. For these reasons 'contestability' has been cast in the role of a possible mitigating circumstance for a full merger analysis, rather than an initial screening indicator in our primary proposal.

5.1.43. Second, there must be unease about the ability of policy to handle the issues associated with strategic groups by means of narrowly defined 'markets'. By their very nature, strategic groups need to be viewed as a network of intra-group and inter-group relationships. A merger may well affect both competition within the group and actual and potential competition between groups. We would therefore argue that these structures need to be viewed as potential oligopolistic networks within a single market, rather than basing the analysis on a separate, narrowly defined market representing only a single piece of the network.

5.1.44. Third, we believe it would be a mistake to under weight the significance of past market conduct versus concentration. Concentration by itself is a very imperfect indicator of the risk of oligopolistic dominance, as already noted. By including market share stability in the initial screening, both the structure and past conduct perspectives are included in the assessment. The basis of judgment is therefore broadened while maintaining a relatively simple set of computations consistent with an initial screen.

5.2. Further investigation of mergers identified by the initial screen

5.2.1. For those merger situations identified as creating a risk of oligopolistic dominance by the initial screen, more detailed and often more judgmental analysis is required. One of the particular problems, for example, is to measure and then weight the many market characteristics which the coordination school flags as influencing to the probability of successful oligopolistic collusion for any given level of industry concentration. We must also ensure that allowing for contestability or threat of entry does not open a door to defences built on unrealistic speculation.

The coordinated action test

5.2.2. Allowing for differences in the susceptibility of a market to coordination, outlined in detail in Table 1, is important and yet difficult from the standpoint of quantification. Table 4 outlines a suggested set of measures. The different role of this test from the incentive to collude test should be noted. The incentive to collude test measures the additional surplus producers stand to gain by effective collusion (their incentive). The coordinated action test, by contrast, is designed to examine the strength of the market forces opposing the stability of any oligopolistic bargain. The two measures therefore act as complements.

Table 4

Indicators of the difficulty of coordinated action within a relevant market

Market characteristic	Measure	Benchmark
Product heterogeneity	Price variation between products	Relative to zero variation
Focal point pricing	Existence of regular, periodic price reviews, price lining and round number discounting	Judgmental
Operating leverage with underutilized capacity	Ratio of fixed costs to total costs	Benchmark sample of EC industries
	Average capacity utilization over the past three years	Relative to 100%
Buyer concentration	Ratio of HHI_{Buyers} to $HHI_{Sellers}$	Relative to lower limit of zero
Market growth or decline	Average of absolute values of industry growth rate over past three years	Relative to zero (perfect stability)
Supplier diversity	Differences in percentage breakdown of total costs between four leading firms	Relative to zero variation
Multimarket contact	Total number of other markets in which any two pairs of rivals in the relevant market meet	Relative to zero

5.2.3. In respect of the difficult issue of weighting these indicators, it is suggested that they jointly form the basis of a clearance test; in other words, if the impediments to successful coordination are identified as high, the merger should be cleared, otherwise it should be further investigated. In applying such a test it needs to be recognized that a high level of any one of the indicators of an impediment to coordination would be enough to thwart oligopolistic dominance. The following procedure is therefore recommended:

(i) that each of the indicators should be ranked on a scale of 1 to 5, 1 representing no impediment and 5 representing a very powerful impediment to coordination;

(ii) that a merger be cleared if any one of the six factors scores 5; i.e. there exists at least one very powerful impediment to oligopolistic coordination;

(iii) that a merger which fails to qualify for clearance under this test be cleared if the average score across all seven impediments is $\geq 3,5$.

5.2.4. The last of these conditions is obviously arbitrary, but the selected critical level is such that, at minimum, four of the seven factors would have to be powerful impediments to coordination in the sense of each scoring 4 on the rating scale before a merger would be cleared on this test.

The trade exposure test

5.2.5. It is recommended that an explicit test of trade exposure be included in the guidelines given that this factor is an important potential influence within many EC relevant markets.[1]

5.2.6. Given that all entry and contestability tests must be based on the behaviour of a theoretical future entrant, setting the precise bounds on the test requires a degree of judgment. For the purposes of discussion the following test is proposed:

'A merger can be cleared on the basis that potential for oligopolistic dominance is limited by trade exposure if a 5% increase in real industry prices would permit a new import supplier to enter the market and exit again after two years or more having recouped via profits any sunk-cost investments required to enter, provided that to do so such a new supplier would not have to win more than a 5% average market share.'

5.2.7. While the precise percentage criteria are obviously open to debate, a number of more general principles embodied in this definition are worthy of note. First, by specifying bounds on the size of the increase in industry prices, the required payback period for recouping sunk costs and the market share an importer might reasonably be expected to win over this period, it is possible to make a reasonably precise calculation of the maximum level of sunk costs which it would be reasonable for a new importer to incur. Without such bounds, we have no benchmark against which to assess whether an estimate of the actual sunk-cost investments required is high or low compared with the possible rewards.

5.2.8. Second, the concept of sunk costs is explicitly included. Measuring sunk costs is conceptually a two-stage process:

(i) the total investment required to capture a given level of market share must be assessed;

(ii) the percentage of this total investment which could be recouped on exit needs to be estimated.

5.2.9. In approaching the second of these tasks, a very useful indicator is to ask the question whether or not relatively liquid secondary markets exist for the different assets which would become available on exit. If the investment required to facilitate imports were a set of multipurpose, refrigerated vehicles, for example, then we would assume a low percentage of these costs would be sunk, since it should be possible to recoup almost all of the investment by selling the assets on the second-hand market. If, by contrast, the importer needed to invest large sums in training sales personnel in the specific attributes and installation requirements of the product, then it would be unlikely that this investment could be recouped by sale of an asset on exit — most of these costs would be sunk (see Kessides (1986) and (1990)).

The contestability test

5.2.10. Compared with entry through trade expansion, the threat of entry which requires substantial investment in local production facilities is perhaps more likely to be muted in practice by high sunk costs and associated lack of contestability. In the past, the opposite has often been assumed. It was often argued that the tangible assets associated with manufacturing were generally more easily resold without substantial loss than the more intangible assets associated with import marketing and distribution (Martin (1989)). Those who have compared the marketability of a used shipyard, blast furnace or chemical plant with that of a consumer brand, might have reason to doubt this assertion.

5.2.11. In order to prevent unrealistic claims about the threat of entry becoming an open door for challenged mergers to gain approval, it is important that the test embody the concept of contestability rather than entry and hence focus strongly on the level of sunk costs relative to potential profits. This is especially true in the light of recent evidence that most entrants fail within a few years (Geroski (1991), Williamson and Verdin, (1992)). The possibility of entry *per se* is clearly insufficient.

5.2.12. Again, as a basis for discussion the following test is proposed:

'A merger can be cleared on the basis that potential for oligopolistic dominance is limited by market contestability

[1] The importance of this effect is increasingly being recognized in the USA; see, for example, Feinberg (1989).

if, on the basis of a 5% increase in pre-merger prices, a potential competitor could expect to be able to establish a viable-scale facility in the market and exit the market within five years of the merger being consummated and still break even on the total profits earned plus the liquidation value of the assets, appropriately discounted for the time value of money.'

5.2.13. This parallels the definition used for trade exposure with two main adjustments. First, it explicitly takes into account the interaction between the minimum viable scale of local facilities and sunk costs (Salop (1991)). Second, it makes allowance for the longer planning time-scale likely to be required to initiate sales based on establishment of a local facility compared with establishing a flow of imports.

The efficiency test

5.2.14. Comparison of the US, UK, German and French guidelines highlighted some of the differences in relative importance given to the possibility that a merger which establishes the conditions for likely oligopolistic dominance will more than offset any consumer welfare loss by the efficiencies it generates. In Germany, in particular, considerable weight was attached to the argument that competition on product quality or R&D would be encouraged by a merger, even if it were to mute price competition.

5.2.15. The arguments here can be complex and are not easily susceptible to the establishment of precise guidelines. The recommendation would be that the burden of proof lies very clearly with the parties to a proposed merger to demonstrate that gains in quality, rate of technological improvement, etc would accrue and equally clearly what forces would ensure that these were passed on to consumers at competitive prices. In this respect, the policy should be particularly wary of the argument that a merger would generate cost savings for the parties since, in an environment of oligopolistic dominance, it is improbable that a substantial share of these savings would be passed on to consumers.

The failing firm test

5.2.16. Being outside the arena of oligopolistic dominance *per se,* this is included only for completeness. Here it is suggested that the new, tighter 1991 US guideline be adopted. Specifically that the failing firm defence cannot be used if the ostensibly failing firm can be sold for just above liquidation value.

5.2.17. A number of these tests, of course, are applicable to the assessment of both single firm and oligopolistic dominance. Others, meanwhile, are specific to the oligopolistic structures. Table 5, below, distinguishes the applicability of each of the major tests proposed.

Table 5

Applicability of the proposed tests

Test	Single firm dominance	Oligopolistic dominance
Concentration	HHI	C^2_n
Stability of market shares		X
Incentive to collude		X
Price-cost margin	X	X
Coordinated action		X
Trade exposure	X	X
Contestability	X	X
Efficiency	X	X
Failing firm	X	X

Conclusion

(a) In an environment of single market integration in the EC, there is a danger that leading firms will attempt to replace the shelter from the winds of competition formerly provided by national boundaries by new networks of oligopolistic coordination. Mergers can play a potentially important role in achieving this objective. Policies which allow for a rigorous examination of the impact of particular mergers on the potential for oligopolistic dominance are therefore likely to be necessary to protect consumer welfare.

(b) Even the theoretical models of the behaviour of oligopolistic structures are characterized by complexity and significant indeterminacies. In these environments, sole reliance on concentration measures is insufficient to match the demands of the issues involved. It is hoped this paper demonstrates, however, that by using a portfolio of indicators it should be possible to predict the probability of a merger giving rise to oligopolistic dominance with acceptable accuracy and that many of the indicators suggested by theory can be implemented in practice. Obviously much work remains before a policy towards oligopolistic dominance can be fully developed. The purpose of this paper is to initiate and focus discussion on the critical issues.

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Annex

Case-studies of oligopolistic dominance

This annex applies the methodology proposed in oligopolistic dominance and EC merger policy to four case-studies drawn from the details of actual US and UK merger cases involving questions of oligopolistic dominance in four different market environments: UK beer, US gasoline, US soft drinks, UK electrical goods retailing.

Its objectives are to:

(i) illustrate the application of the proposed tests to actual merger situations;

(ii) begin to assess the feasibility of obtaining the data necessary to execute the proposed tests;

(iii) begin to assess the robustness of the proposed methodology for analysing the risks of oligopolistic dominance created by particular mergers; and hence

(iv) help identify the strengths and weaknesses of the proposed methodology.

Case-study 1: Elders IXL Ltd and Grand Metropolitan plc

1. The issues

This case-study focuses on the proposed merger of the UK beer-brewing interests of Elders IXL Ltd and Grand Metropolitan plc, respectively the sixth- and fourth-largest suppliers to the UK market at the time of the case in 1989.

A key issue in this case was the reduction of major rational suppliers from six to five and the associated risk of the post-merger market exhibiting oligopolistic behaviour against the public interest. This question was sharply distinguished from the more usual issue of single firm dominance, because the merged company would not have been the largest player in the post-merger market.

Elders IXL Ltd was an Australian company with a turnover of UKL 8,6 billion in 1989 and involved in four major businesses: brewing, agribusiness, financial services and resources. In 1986 it acquired the Courage Group whose main activities were the production, wholesaling and retailing of beer and the operation of public houses (pubs) in the United Kingdom. The turnover of Courage Ltd in the year to June 1989 was UKL 695 million.

Grand Metropolitan plc is a major food, drinks and retailing company with interests worldwide. In 1989 its turnover was UKL 9,3 billion. Its brewing subsidiary was the UK's fourth-largest brewer. The turnover of its brewing and retailing interests (pubs and pub-restaurants) in 1989 was UKL 636 million.

On 27 April 1990 the UK Monopolies and Mergers Commission was asked to investigate a proposed transaction between these two companies involving:

(i) the acquisition by Courage Ltd of Grand Metropolitan's brewing interests;

(ii) the acquisition by Elders IXL (Courage's parent) of a 50% holding in a new company, Inntrepreneur Estates Ltd (IEL), which would purchase the assets associated with Grand Metropolitan's 3 565 public houses. The remaining 50% of IEL would be held by Grand Metropolitan.

If this transaction were to proceed, Courage Ltd would control approximately 20% of the total UK market for beer and 23% of the UK market in the lager segment.

Even so, it would remain smaller than Bass plc, the major competitor, which supplied 22% of the total beer market and 24% of the lager segment in 1989. Other large brewers controlled significant shares of the total beer market as follows: Allied Lyons (12%), Whitbread (12%), Scottish & Newcastle (10%), as detailed in Table 6.

Table 6

National brewers' shares of total UK beer sales, 1989

%

Brewer	Total market	Ale	Lager
Grand Metropolitan	11	9	13
Courage	9	9	10
Total	20	18	23
Allied Lyons	12	12	13
Bass	22	20	24
Whitbread	12	12	12
Scottish & Newcastle	10	13	7
All national brewers	77	75	78

Source: MMC's beer report (1989) and Grand Metropolitan Courage estimates.

In the light of this market structure, the issue was not a fear that Courage Ltd would be in a position to exert monopoly power through single firm dominance if the transaction were to proceed. Instead, the concern was that the loss of one of the national brewers, reducing the number to five, would expose the industry to a risk of oligopolistic dominance. Specifically that, following the proposed merger, Courage Ltd and the leading competitor Bass plc would together 'be likely to have around 40% of the market for beer and 47% of the lager market' and that in view of the concentration of much of the remaining market being in the hands of three other large players, the effects were likely to be 'adverse to the public interest that competition for the supply of beer at the wholesale level would be reduced and result in wholesale prices being higher than they would be in the absence of the merger'.[1]

2. The initial merger screen

The initial merger screen was envisaged as a test that could be applied rapidly to determine whether a proposed merger warranted further detailed investigation. The decision would be based on two quantitative measures: immediate post-merger industry concentration and past stability of market shares.

2.1. Post-merger industry concentration

The post-merger industry concentration, based on the recommended C_4 measure, would be 66%. This substantially exceeds the suggested level of < 50% for clearance on the concentration test. It is perhaps worth emphasizing that this is despite the fact that the single firm dominance resulting from the merger is only 20% and that Courage Ltd, post-merger, would still only be the second-largest firm in the industry. The point is that the leading four firms could be expected to control a high share (66%) of the post-merger market. As a point of comparison, the Herfindahl-Hirschman index (HHI) for this market falls towards the lower end of the range 1 000 to 1 800 with a change in HHI of > 100. This would place the merger in the indeterminant range where challenge depends on other aspects of market structure under the 1992 US merger guidelines.

Our proposal to focus on C_4 de-emphasizes the prevailing industry structure outside the four leading firms. The question it poses is: do the four largest firms share enough of the total market between them to have a chance of dominating the market if they were to pursue some form of oligopolistic coordination? The prospective C_4 of 66% share answers this question in the affirmative: the risk of oligopolistic dominance appears to be significant.

2.2. Past stability of market shares

Applying the second part of our initial screen, the 'past market share stability of market shares test', the relative share instability (RSI) measure suggested by Caves and Porter (1978) takes the value of 0,057 computed over the preceding three years for the four largest firms.

In the absence of current European industry benchmarks (which would need to be computed as part of the implementation of this part of the guidelines), a rough indication is provided by Caves and Porter's data for their sample of 470 manufacturing business for the late 1970s. The average value of RSI for this sample was 0,115 with a standard deviation of 0,140.

Compared with this (albeit rough) yardstick then, the UK brewing sector exhibits significantly 'above-average' stability of market shares. In summary, while the application of the US HHI test would categorize this merger in the 'indeterminant' range, our proposed screen (combining concentration measured by C_4 and past stability of market shares) would highlight this merger as one requiring further detailed investigation.

3. The coordinated action test

For mergers that are not cleared on the basis of our initial screen we proposed a next stage of analysis designed to assess the likelihood of viable coordinated actions between oligopolists given various features of industry structure and past conduct. These included product heterogeneity, focal point pricing, operating leverage and underutilized capacity, buyer concentration, market growth or decline, supplier diversity and multimarket contact. After examining this portfolio of measures (which individually may give conflicting signals about the likelihood of coordinated action) investigators would need to reach an overall judgment — since theory does not suggest a precise weighting for each individual indicator.

3.1. Product heterogeneity

Our suggested measure for this variable was the price variation between products relative to a benchmark of zero variation. Unfortunately, while the UK Monopolies and Mergers Commission looked at the evolution of wholesale

[1] Monopolies and Mergers Commission, 'Elders IXL Ltd and Grand Metropolitan plc — A report on the merger situations', October 1990, p. 1.

and retail prices over time, they did not conduct an analysis of inter-product price variations at any one point in time. This can be regarded as one area of weakness in many traditional merger analyses. We do, however, illustrate the use of this price variation indicator in the case-study No 4 concerning a proposed merger in the retail industry.

3.2. Focal point pricing

The availability of clear pricing focal points, which can be expected to greatly facilitate coordinated action, is a key feature of the UK beer market. It is the general practice of the large national brewers to publish a wholesale trade price-list. This often listed variations in the price at which beer would be sold to wholesalers and retailers between different parts of the country.

Many industries publish such wholesale price-lists. But their suitability as a focal point for pricing is often limited by substantial and unpredictable discounts off the list price made to individual customers.

In the UK beer industry, however, approximately 45% of all sales are made through so-called tied houses — public houses that are either owned by the brewers and leased to an operator or contractually tied to a particular brewer through a long-term supply agreement. These buyers generally do not receive discounts off the published price-list.[1] Although the brewers' other customers (i.e. non-tied free-trade houses, the tenants of other brewers, national accounts and wholesalers) receive discounts based on individual negotiations, the fact that almost half the market operates on a list price means there is a strong focal point on which coordinated pricing might be based. Moreover, the resulting transparency of pricing limits the probability that 'cheating' on any tacit price coordination will go undetected.

3.3. Operating leverage with underutilized capacity

The beer industry involves high fixed costs at each stage in the chain: manufacturing, distribution and public-house retailing. Therefore operating leverage is high. This creates a significant incentive for oligopolists in the industry to 'cheat' on any tacit agreement to coordinate prices since the net marginal revenue (contribution margin) from additional sales tends to be high (provided such 'cheating' went undetected and the oligopolistic price umbrella was maintained). For high operating leverage to present a threat to an implicit oligopolistic bargain, however, significant excess capacity must exist within the industry (without this oligopolists have no prospect of increasing short-term sales).

In fact, the UK brewing industry was operating at an estimated 75% capacity utilization at the time of this merger case. Moreover, this excess capacity was unevenly distributed between the major players. This situation creates differential incentives to cheat on any tacit oligopolistic bargain, with low-utilization competitors having a stronger incentive to try for additional sales through price cuts they hope will not be detected.

These considerations argue that oligopolistic coordination on prices would be difficult to maintain in the industry. However, it should be kept in mind that due to the use of list pricing, undetected cheating is very difficult to execute, at least in the 50% of the market where individual discounts are unusual. Therefore, successful oligopolistic coordination may be possible despite high operating leverage and under-utilized capacity.

3.4. Buyer concentration

Buyer concentration in this industry is very low. The major brewers sell direct to an estimated 199 000 customers (including public houses, clubs and retail stores or off-licences). Few of these are organized into chains or buying groups that would increase their bargaining power. The ratio HHI_{Buyers} to $HHI_{Sellers}$ is consequently very low. We cannot expect that the buyers will exert significant countervailing force against oligopolistic coordination in this industry.

3.5. Market growth or decline

After reaching a peak in 1980 at 40,7 million barrels per annum, the demand for beer in the UK fell quite sharply in the early 1980s. The consumption has then remained static since 1985 at between 38 and 39 million barrels per annum.

This stability in the total size of the market would encourage oligopolists to avoid aggressive competition on price — they know that any increase in sales would come primarily at the direct expense of competitors' sales (a zero-sum game). Hence the likelihood of rapid retaliation to any price cut is arguably higher than in an industry where demand is growing rapidly (in which case expanded sales would be possible without an absolute contraction in competitors' sales). The stagnant market is therefore likely to promote the maintenance of oligopolistic coordination.

[1] Although special promotions (for example, one free barrel or case for a certain number of barrels/cases ordered) are sometimes made.

3.6. Supplier diversity

The major UK brewers have remained a relatively stable group of competitors over the past two decades. The main increase in supplier diversity has resulted from takeover activity — particularly the entry of Elders (based in Melbourne, Australia) through its purchase of the Courage Group in 1986 (then with a market share of 9%) from Hanson plc.

All the major UK competitors rely on UK production capacity and similar distribution channels (although some are more dependent on sales to 'free' retailers — those without a long-term contractual tie to a particular supplier).

The level of supplier diversity in this industry therefore tends to be relatively low compared with an industry where competitors with very different historical or national backgrounds come together in the same market-place. This low level of supplier diversity is another indicator that coordination between oligopolists is likely to be facilitated by broadly shared goals and similar challenges across the participants in the UK beer industry.

3.7. Multimarket contact

While the four largest players in the UK brewing industry tend not to meet each other in multiple geographic markets, they are competitors in other, related businesses (such as restaurant chains and spirits). This increases the options for retaliation against aggressive price behaviour in the beer market. Specifically it opens the way for retaliation in a second product market where the cost of disciplining an aggressive competitor may be lower. A network of tacit threats and counter-threats between the major competitors in the UK beer market would therefore be feasible, thereby increasing the probability that effective oligopolistic coordination could be sustained.

3.8. The coordinated action test — Summary

As already noted, this test involves a number of potentially conflicting indicators. In the UK beer market, however, a pricing structure that provides clear focal points for coordinated pricing and facilitates the detection of cheating on a tacit agreement, combined with static market demand, a low level of supplier diversity, buyer fragmentation and multimarket contact between the major competitors, points to a market structure conducive to oligopolistic coordination.

The presence of high operating leverage combined with significant excess capacity in the industry remains the one structural test which suggests difficulties may be experienced in sustaining any tacit coordination. These structural features create a strong incentive to attempt to capture marginal sales. However, since the remaining structural features of the market (especially pricing transparency) increase the probability that cheating on tacit price coordination will be detected, the incentive to secretly cut prices will be offset by the high risks of doing so.

Overall then, the coordinated action test suggests the structure of this market makes it fertile ground on which to build oligopolistic coordination.

4. The trade exposure test

At the time of the proposed merger in 1989 imports into the UK beer market amounted to some 2,8 million barrels — just over 7% of total consumption. While imports had been growing rapidly they had begun from a low base volume. Third parties giving evidence to the Monopolies and Mergers Commission, however, suggested that high transportation and distribution costs imposed a significant barrier to the growth of beer imports beyond a niche market share.

The fact that the majority of 'imported brands' are actually brewed under licence in the UK provides further evidence of limited trade exposure. A plausible interpretation of this policy is that potential import suppliers and foreign entrants find it more economic to license their brands and recipes to major forward-integrated local producers, thereby avoiding high transport costs and the expense of obtaining nationwide distribution to fragmented retailers which would combine to make direct export uncompetitive.

These considerations would lead us to discount exposure to import competition as a factor which might otherwise mitigate the effects of oligopolistic coordination among the major UK suppliers of beer. Trade exposure seems insufficient to eliminate the possibility of oligopolistic dominance.

5. The contestability test

Recall that our proposed market contestability test was as follows:

'A merger can be cleared on the basis that potential for oligopolistic dominance is limited by market contestability if, on the basis of a 5% increase in pre-merger prices, a potential competitor could expect to be able to establish a viable-scale facility in the market and could exit the market within five years of the merger being consummated and still break even on the total profits earned plus the liquidation value of assets, appropriately discounted for the time value of money.'

At the core of this contestability test is the requirement that a potential entrant can move into the market without incurring significant sunk costs — either because the required investment is low, or because the liquidation value of the required assets would be close to their investment cost on exit.

The viable entry scale is the first determinant of sunk-cost investment required that must be considered.

In addition to the six large brewers (with a combined share of 75%), there are estimated to be some 60 other brewers in the UK. Many of these small brewers trade only locally. It is also estimated that a similar number of very small brewers had entered the UK market during the early 1980s, including micro-brewers established inside public houses. A detailed study of the market in 1985 estimated that regional brewers supply 11% of the market, local brewers 6% and micro-brewers around 1%. The remaining 7% of the market was supplied by medium-sized firms who sold their product on the open market rather than through long-term supply contracts to a tied estate of public houses.

Thus there is evidence of significant numbers of new firms entering the market at a small scale. By selling locally, often attracting customers by word of mouth (therefore avoiding heavy investment in national brands) and by using new, small-scale technologies, these firms have been able to establish viable operations while keeping sunk-cost investments to a minimum.

It could, therefore, be argued that the market is contestable and that the proposed merger should be cleared on this basis. In fact, however, this contestability can really only be said to apply to the fringe-sector brewers — those with regional or local market shares and whose brands cater to specialist niches around the leading national players' offerings. The limited growth in market share by existing and new regional and local competitors over the past decade would support the following conclusion: that the possibility of small-scale entry with low sunk costs cannot be expected to act as an effective price discipline against oligopolistic coordination between the large national players.

This points out a potential weakness in the proposed contestability test: it has difficulty distinguishing between contestability limited to a fringe segment versus contestability of the mainstream of a market dominated by a group of oligopolists.

There are three potential ways of dealing with this problem:

(i) To use a definition of the relevant market that excludes the contestable fringe. The relevant market would be defined to include only the branded national players.

(ii) To augment the definition of contestability by requiring that entry must be such that it would reduce the post-merger HHI by a significant (specified) amount, as well as being feasible at low sunk cost (this is essentially the approach adopted by the new US merger guidelines that calculate the HHI after allowing for entry by new competitors as if they were already established in the market).

(iii) Simply to add a requirement that contestability must not only be possible, but that it must result in a market structure, post-merger, where the risk of damaging oligopolistic coordination would be low on the basis of the concentration and coordinated action tests detailed above.

This may argue for moving the contestability test earlier in our sequence of tests so that it was applied to all proposed mergers selected for further investigation based on the initial merger screen, prior to the coordinated action test.

6. The efficiency test

The parties to the proposed merger mounted a strong argument that the transaction would permit them to improve efficiency through expected economies of scale. While this claim is doubtlessly true (and may have been an important motivator for the merger), our proposed efficiency test requires that the proponents show that:

(i) significant efficiency benefits will accrue; and

(ii) that there will be sufficient competitive forces in the post-merger market to ensure that a substantial proportion of these benefits will be passed on to consumers in the form of lower prices for any given level of quality.

In view of the conclusion of our analysis regarding concentration, past stability of market shares and the likelihood of coordinated action, however, there must be severe doubts that any substantial proportion of any efficiency benefits will be passed on to consumers. The proposed merger would not be cleared on the efficiency test.

7. The failing firm test

There was no suggestion that either of the parties would be forced to exit the business if the merger did not proceed.

8. Summary discussion of the Elders/Grand Metropolitan beer case

The UK Monopolies and Mergers Commission found that the proposed merger of the Elders IXL and Grand Metropolitan brewing interests 'may be expected to operate against the public interest with the particular effects adverse to it that competition for the supply of beer at the wholesale level would be reduced and result in wholesale prices being higher than they would be in the absence of mergers'.[1]

Some of the main considerations on which this judgment was based included:

(i) that 'the loss of one of the national brewers reducing the number from six to five would significantly increase concentration';

(ii) that the two largest competitors in the market, post-merger, Bass plc and the post-merger firm Courage plc, would 'together be likely to retain a market share of around 40%' with adverse effects on prospective competition;

(iii) that, while the Commission 'reached no adverse conclusion on the effect of the merger on new entry and the growth of existing suppliers', it noted that both Bass plc and Courage plc 'have powerful brands, particularly in the larger market where between them they would have about a 47% share'.

The MMC also recommended certain remedies which, if implemented, it believed would prevent the adverse effects of the merger. The most pertinent to our considerations here was that the parties:

'... amend the transaction so that the merged brewing interests immediately after the proposed merger would have a market share of around 15% of the supply of beer in the United Kingdom on the basis of 1989 sales (as compared with a prospective 20% under the proposed transactions). We consider that in order to achieve this the parties will have to dispose of some of their major ale and lager brands and consequently some of their brewing capacity.'[2]

As this case example illustrates, the series of tests proposed would likewise have recommended that the merger be opposed on public interest grounds. However, there are some significant differences, with the process adopted and tests applied by the UK MMC. These are:

(i) that our suggested approach would have provided the parties with a much clearer set framework for assessing whether or not their proposed merger would be opposed on the basis of a risk of oligopolistic dominance;

(ii) that the proposed initial merger screen would have provided an early decision on whether the merger required detailed investigation;

(iii) that past industry conduct, as reflected in the past stability of market shares, would have been used to help decide whether the increase in concentration associated with a reduction in the number of UK national brewers from six to five was likely to lead to a significantly increased risk of oligopolistic dominance. Since this is by no means a clear-cut judgment, and concentration theory is equivocal on this point, this case demonstrates the importance of having a second indicator as part of the initial screen;[3]

(iv) that, while the UK MMC implicitly considered many aspects of market structure which might influence the risk of post-merger oligopolistic dominance, our proposed series of tests explicitly lists a set of indicators that will be considered, and benchmarks against which these will be assessed. The proposed tests also make it clear how (and why) each aspect of market structure will be used to assess the likelihood of coordinated action, post-merger;

(v) that trade exposure, efficiency and failing firm considerations only need to be taken into account if it has been concluded that the risk of coordinated action is unacceptably high.

More generally, this case-study demonstrates that the kinds of data required to implement the proposed tests should be feasible to obtain and, moreover, that they draw on much the same variables that are already assessed by an organization like the UK MMC.

At the same time, this case example suggested a potential problem with the proposed contestability test in the situation where the market fringe was contestable but the bulk of the mainstream market was, in practice, non-contestable.

1 MMC report No Cm 1227, p. 63.
2 MMC report No Cm 1227, p. 65.

3 Note also that the US merger guidelines HHI test is in the indeterminant range for this proposed merger.

Three solutions were suggested to adjust the definition of the relevant market, to augment the definition of contestability so as to assess its practical impact in terms of its effect on post-entry concentration, or to move the contestability test earlier in the sequence so that the coordinated action test could be applied after an allowance for contestability had been made.

Case-study 2: The US petroleum industry — Mobil/Marathon

1. Background

On 31 October 1981, Mobil Corporation announced a tender offer for shares sufficient to acquire control of the Marathon Oil Company. The Marathon Board concluded that this hostile takeover was not in the interests of Marathon's shareholders, employees or the communities in which it operated. As part of their campaign to thwart the takeover, Marathon filed a US antitrust suit charging that the merger of Marathon with Mobil would lessen competition in diverse crude oil, refined product, and oil transportation markets.[1]

At the time of the case, Mobil was the fourth-largest refiner of petroleum products in the USA, accounting for 6,3% of total US motor gasoline sales. It was a vertically integrated supplier with strong international presence.

Marathon, which had begun as Ohio Oil Company following the split-up of the Standard Oil Trust in 1887, changed its name to Marathon Oil in 1962 after moving into refining and crude oil operations in other parts of the USA and internationally. It was the ninth-largest domestic petroleum refiner, with a 3,7% share of US nationwide gasoline sales.

In the US market Mobil had an imbalance between its crude oil reserves and its refining capacity. Its crude oil extraction operations were sufficient to supply only 37% of its US refining capacity of 860 000 barrels per day. Its proven US crude oil reserves had an expected life of only 6,5 years at 1980 production volumes. Mobil was anxious to acquire additional US crude oil reserves, partly to reduce its exposure to international supply disruptions.

Marathon, by contrast, had US crude oil production of 168 000 barrels per day, equivalent to half of the capacity of its US refineries. In particular, Marathon had a 49% interest in the Yates field of West Texas — the second-largest oil reservoir in the USA. Marathon's share of the reserves in this field were conservatively estimated at over one billion barrels — sufficient to support current production levels for another 44 years.

The core question was whether competition would be substantially lessened. This was a question of oligopolistic, rather than single firm dominance since a combination of the fourth- and ninth-largest competitors would not have created a firm with independent monopoly power. Before this could be considered, however, a definition of the relevant market was required.

2. Market definition

There was no substantive dispute regarding the appropriateness of gasoline as the definition of the product market (although the original suit had mentioned other markets including crude oil and crude oil transportation). A major point of contention, however, was the choice of the relevant geographic market. Should it be national (as claimed by Mobil) or a narrower definition (based on metropolitan areas, states or regions of the USA) as claimed by Marathon.

After examining considerable and often conflicting interpretations of the evidence on geographic pricing differentials, the District Court stated that:

'The persistence of price differentials in various areas of the nation demonstrates that motor gasoline does not move from area to area in response to price changes easily or as readily as Mobil assents. Rather, they indicate that the relevant market for motor gasoline is something less than nationwide. Clearly, such an analysis must be more fully developed at a trial on its merits.'[2]

The case proceeded to consider the competitive position based on two main definitions: a single national market and separate state markets. We use the national market for the purposes of illustration in what follows.

3. Applying the proposed initial merger screen

Using the national market definition, the four-firm concentration ratio pre-merger was 31,4%. This would rise to 34,5% following the proposed merger (see Table 7).

[1] *Marathon Oil Co.* v *Mobil Corporation et al.*, Northern District of Ohio, 530 F. Supp. 315 (1981).

[1] *Marathon Oil* v *Mobil*, op. cit., p. 322.

Table 7

Concentration ratios in the US petroleum industry, 1980

	(%)
Four-firm concentration ratio	31,4
Eight-firm concentration ratio	54,3
Mobil's share	5,4
Marathon's share	3,1

NB: Based on volume throughputs in US refineries.

Using the HHI concentration test in the current (1992) US merger guidelines, the Mobil/Marathon merger would fall in the 'unlikely to challenge' range due to a combination of relatively low pre-merger market HHI and a modest increase in HHI. In the actual case hearing (under earlier US merger guidelines), the economist witnesses for Marathon and Mobil agreed that concentration in the industry lay on the low side of the range where oligopolistic behaviour (either collusion or 'live and let live' pricing) emerges. But neither was willing to identify a precise numerical point at which competitive structure ends and oligopoly begins.[1] The Mobil economist testified:

'I would be misrepresenting both my knowledge and the knowledge of the profession if I said that there is a critical point measured by one concentration measure or another beyond which thou shalt not tread ... But there is a relationship which, beyond a certain point, causes most economists to worry about competitive behaviour.'

Mobil, however, pointed to a generally declining trend in the favoured eight-firm concentration ratios to support its contention that the risk of oligopolistic coordination was low.

The concentration test alone, therefore, is inconclusive. However, if we apply the second element of the proposed initial screen — the past stability of market shares — the picture is somewhat different. The RSI index among the leading four firms for this industry in the late 1970s is significantly below the average in the Caves-Porter industry sample for 1977 — suggesting that the shares of the major players tend to be unusually stable.

Thus the two dimensions of our initial screen give somewhat conflicting signals placing this merger in the upper left quadrant of our initial screen matrix, indicating the need for further expansion.

We can speculate that there may be at least two reasons for this result. It may be that, despite relatively low concentration overall, the major firms act as a relatively tight oligopoly. Alternatively, it may be that geographic segmentation in the US national market means that only a subset of the larger suppliers meet head-to-head in any one region so that oligopolistic coordination is facilitated compared with what national concentration statistics might suggest.[2]

Independent of the cause, however, this example illustrates how, by looking at past stability of market shares, we might usefully mitigate some of the limitations of solely relying on concentration measures, especially when the possibility of underlying geographic market segmentation exists (helping oligopolists to mute competition and stabilize market shares despite moderately low levels of concentration measured nationally or regionally).

4. The coordinated action test

Our initial merger screen suggests the Mobil/Marathon case warrants application of the coordinated action test.

4.1. Product heterogeneity

Despite frequent attempts by leading producers to differentiate their offerings on the basis of product formulations, gasoline remains among the most homogeneous of product groups. This absence of significant quality differences tends to facilitate coordinated pricing action among oligopolists.

4.2. Focal point pricing

In the consumer market prices are usually prominently displayed at the outlet, making it difficult for any player to cheat on a tacit price agreement by discounting and hope to go undetected. The only significant exception to this is the market among bulk buyers (either industrial users or independent retailers) where discounts can more easily be kept secret.

At the same time, because the crude oil input (a very important determinant of any producer's final costs) is openly traded in world markets, each oligopolist can readily obtain

[1] See Scherer, F. M., in Kwoka, J. E. and White, L. J. (eds) (1989), *The antitrust revolution*, New York, Harper Collins, Chapter 1.

[2] Unfortunately interpretation is further complicated by the imposition of government price controls at various times during the 1970s.

information on a key element of each competitor's costs and how they are changing over time.

This combination of pricing transparency and a focal point (in the form of the published price of crude oil) helps to facilitate successful oligopolistic coordination in the gasoline market, despite external pressures for frequent, and sometimes volatile, price changes.

4.3. Operating leverage/capacity utilization

Just prior to the proposed merger, gasoline prices in the USA had soared with the phase-out of US price controls and an increase in OPEC's crude oil prices from around USD 15 per barrel in 1978 to USD 34 in 1981. As a result, the volume of gasoline demanded fell sharply and US refineries were operating at only 66% of their effective capacity (compared with a target utilization of 90 to 95%).

If this low level of utilization were to continue, there would be strong pressure for individual suppliers to cheat on any tacit oligopolistic coordination in view of the capital-intensive, high fixed-cost nature of the refining business.

Two other considerations, however, would lead us to doubt that low capacity utilization would destroy the potential for oligopolistic coordination in this industry. First, the refining industry was undergoing structural change with strong pressure on small-scale, uneconomic refining capacity to exit the business.

Second was the existence of small, independent gasoline marketers (who bought refined gasoline and on-sold this through limited retail distribution channels which lacked well-established brands — known as 'white pumpers' in Europe). These independents meant there was a channel through which a refiner could dispose of excess refining capacity without directly cutting the retail prices of its own mainstream branded output. Therefore a 'safety-valve' existed where the impact of excess capacity could potentially be channelled into a fringe segment of the market (where price competition is strong) with a reduced threat to the remaining oligopolistic segment dominated by the eight largest suppliers and accounting for an estimated 80% of the US retail gasoline market.

Most of the large suppliers, including Mobil, did not sell directly to the independent fringe, although during periods of excess supply when a safety valve was needed 'major companies' gasoline found its way into independents' intermediaries'.[1]

[1] *Marathon Oil* v *Mobil*, op. cit., testimony of J. Blum, transcript pp. 178-182.

4.4. Buyer concentration

Due to the vertical integration of the major refiners into retail distribution (through a mix of ownership, franchising and other long-term contracts) the ratio of HHI_{Buyers} to $HHI_{Sellers}$ is very low. The countervailing power of buyers is against the effects of oligopolistic coordination.

4.5. Market growth/decline

After a long period of moderate but steady growth the gasoline market in the USA began to suffer severe external shocks from a combination of regulation and OPEC pricing in the 1970s, as already noted above. These expansion and contraction shocks would place considerable strains on any oligopolistic bargain.

However, any oligopolistic coordination might be expected to survive these shocks if the producers regarded the changes as essentially temporary and took a long-term view of the evolution of prices in the industry.

The fact that the oil majors did not generally sell directly to independent marketers even when under strong pressure to improve their own capacity utilization in refining (but rather made use of a more indirect safety valve) provides some evidence for this kind of long-term thinking. This might lead us to suspect that oligopolistic coordination could be resilient in this industry despite volatile demand growth and decline.

4.6. Supplier diversity

As already implied, the suppliers to the US gasoline market fell into two main groups, the majors and the independents, with roughly an 80:20 split in overall market share.

In addition to the increase in concentration among the majors (the 'big eight'), there was a concern that the proposed merger could reduce overall supplier diversity. The reason was that Marathon was the major supplier to the independents, while its prospective new owner (Mobil) had a policy of refusing to supply direct to independents at all.

Thus it was argued that the acquisition of Marathon could constrain the ability of the independents to act as maverick competitors in the market and perhaps even undermine their long-term viability. By eliminating a primary source of supply to the independents, they may face a shortage of refined product or be forced to pay higher prices. This would, in turn, reduce their ability to exert price discipline on the majors.

For this reason, there was a danger that the proposed merger would effectively reduce diversity of supplier behaviour and increase the risk of successful oligopolistic coordination.

4.7. Multimarket contact

While the major suppliers to the US gasoline market do not generally meet in other major product markets, they do come face to face as competitors in other geographic markets due to their international spread. This opens up possibilities for threats of retaliation in third markets as a way of maintaining oligopolistic coordination in the US market.

4.8. The coordinated action test — Summary

A high degree of product homogeneity, pricing transparency, the role of crude oil markets as a pricing focal point and low buyer concentration all signal a structure generally conducive to oligopolistic coordination.

Doubts about the sustainability of oligopolistic coordination centre on (relatively recent) excess capacity and volatility in demand growth, along with supplier diversity in the form of independents with approximately 20% market share.

The fact that the proposed Marathon-Mobil merger might restrict the operations and pricing flexibility of these independents was therefore of considerable concern. In the post-merger market their effectiveness in price discipline against the majors might be limited by the elimination of Marathon as a primary supplier to this sector of the market. Worse still, as their dependence on the majors for supply of refined gasoline increased, they may be forced further into the role of a safety valve for excess capacity among the majors (helping to cement oligopolistic coordination) rather than acting as potent competitors.

5. The trade exposure and contestability tests

Although crude oil imports accounted for an important part of total US crude consumption, transport and refining economies meant that US gasoline was refined locally. As a result, the gasoline market was effectively insulated from trade competition. Entry would require large minimum-scale investments, even if sales were made through independent retailers. To sell direct would require large, additional investments in distribution, retail outlets and branding, a large proportion of which would be represented by sunk costs.

For these same reasons, the US gasoline market fails to satisfy the criteria for market contestability, namely that a new supplier could enter at viable scale and subsequently exit without incurring significant losses on sunk-cost investments.

Neither trade exposure nor contestability, therefore, could be expected to counteract oligopolistic dominance should it arise.

6. The efficiency test

Mobil was unable to convince the District Court that the proposed merger would 'benefit the economy, increase operating efficiency, bring advantages of scale, or substitute better management'.[1]

Even if there had been such benefits, however, it is not clear how a substantial proportion could be expected to flow through to consumers given the general concerns about the risk of oligopolistic dominance emerging from earlier stages of our analysis.

It is perhaps worth making the point here that in many cases application of the efficiency test will be redundant in practice since, even if efficiency gains could be proved, it would be virtually impossible to establish that they would be passed on to consumers if the previous stages of the analysis concluded that the risk of oligopolistic dominance was high.

Indeed, the only instance in which the efficiency test would lead to a merger being cleared is the case of large potential gains in efficiency alongside a relatively weak to moderate risk of oligopolistic dominance — so that efficiency gains might be decisive in tilting the balance in favour of the merger.

7. The failing firm test

There was no suggestion that either firm would be forced to exit the market if the merger were not to proceed.

8. Summary discussion of the Mobil/Marathon case

In the actual case before the District and Federal Courts in the USA, a detailed examination of the behaviour of prices in the US gasoline market left serious doubts as to whether

[1] *Marathon Oil Co.* v *Mobil Corporation*, 669F.2d 1981, p. 382.

there existed effective competition throughout the market. The evidence suggested that a situation where a set of dominant oligopolists, controlling three quarters of the mainstream branded market faced only limited competition from independent retailers with around 20% combined market share (albeit that competition from this source tended to be localized and perhaps sporadic — depending on the supply situation for refined gasoline).

Against this market background, the proposed acquisition of Marathon by Mobil threatened to:

(i) strengthen the dominance of the 'big eight' players and increase the likelihood of successful oligopolistic coordination;

(ii) reduce the effectiveness of the independents as a source of price competition.

These effects would stem primarily from the fact that Marathon had been a consistent, reliable source of supply to the independents. Its prospective new owner, by contrast, had maintained a policy of refusal to supply direct to independents at all.

At the same time, however, the overall concentration ratio in the market and the increase in concentration which might result from the proposed merger were both below the thresholds where a strong challenge could be mounted on the grounds of concentration.

The US courts took the route of accepting that the analysis should be based on a narrower geographic definition of the relevant market — the individual states. This meant that the proposed merger would push concentration above the guideline levels in six states: Ohio, Illinois, Indiana, Michigan, Wisconsin and Florida. An injunction was therefore issued against Mobil by the Federal District Court in Cleveland.

The logic of the judgment began to show some signs of inconsistency, however, when Mobil offered to sell off Marathon's refining and marketing operations in the six offending states and yet the Court still refused to leave the injunction.

While an extended legal battle continued, Marathon was acquired by US Steel Corporation as a 'white knight', thwarting Mobil's strategy.

In fact, since this antitrust decision was based on concentration in specific geographic market segments (even though the implicit concern was a more general one about oligopolistic behaviour throughout the US market), the Mobil/Marathon decision did not put an end to major petroleum industry mergers. This subsequently included Mobil's purchase of Superior Oil (USD 5,7 billion), US Steel's acquisition of Texas Oil and Gas, Texaco's acquisition of Getty Oil (although it agreed to divest some of Getty's marketing network), Standard Oil of California's acquisition of Gulf Oil and Occidental Petroleum's purchase of Cities Service.[1]

Our proposals for policy on oligopolistic dominance are designed to face the risks of oligopolistic behaviour more directly than was possible under the US merger guidelines at the time of the Mobil/Marathon case. As we have seen, this approach involves its own uncertainties and exercise of judgment. However, we believe it has advantages over a policy that is essentially designed to deal with single firm dominance, relies heavily on concentration, and has to be stretched uneasily to deal with oligopolistic situations. Some of these problems associated with stretching a single firm dominance framework into the sphere of oligopoly are well illustrated in the Mobil/Marathon case.

The initial merger screen proposed in our series of tests provides a second window into the possibility of oligopolistic dominance (past stability of market shares) in an industry like US gasoline in the early 1980s where pricing and shifts in market share would appear to be the result of less than robust competition despite only moderate concentration. It is even more important to have a second measure to support the concentration indicator in a case like Mobil/Marathon where a proposed merger could weaken a significant source of discipline on the behaviour of oligopolists (as might have been the case with the US gasoline independents) even though the direct increase in concentration may have been modest.

In this case-study we illustrated how, having signalled a possible problem of oligopolistic dominance, more detailed analysis could proceed using the basket of measures included in our coordinated action test. These indicators painted a picture of a market where the structure was generally conducive to oligopolistic coordination. Nor was there significant exposure to trade or new entry without substantial sunk-cost investments that could threaten to destabilize coordinated behaviour among oligopolists.

It is probable that the proposed Mobil/Marathon merger would have been rejected under the guidelines we have proposed. Unlike the US court decisions at the time, however, such a rejection would have been based on unacceptable risks of oligopolistic behaviour across the US national market (rather than single firm dominance in limited geographic

[1] See Scherer, op. cit., p. 28.

areas). As a result, the proposed guidelines would have provided a stronger precedent for the challenge of the subsequent merger cases which progressively increased the risk of oligopolistic dominance in the US gasoline market.

Case-study 3: The proposed merger of Coca-Cola and Dr Pepper

1. Background and issues

One of the most interesting aspects of this case for our current purposes is that the discussion of market conditions that might help or hinder coordinated behaviour among oligopolists of carbonated soft drinks (CSDs) in the USA became an important part of the trial (in addition to more commonly debated factors including market definition, market shares and analysis of entry conditions).

In early 1986, the Coca-Cola Company announced its intention to acquire the Dr Pepper Company and to combine the two operations. Just over three weeks earlier, PepsiCo had stated an intention to purchase the Seven-Up Company (then a subsidiary of the Philip Morris Corporation).[1]

If these planned mergers were to proceed, they would result in consolidation of the four leading players in the US CSD market down to just two firms.

In June 1986, the US Federal Trade Commission (FTC) decided that it would oppose these mergers as anti-competitive (after four months of investigation). PepsiCo and Seven-Up subsequently abandoned the merger plans. The Coca-Cola and Dr Pepper merger became the subject of a trial in the Federal District Court.

2. Market definition

There were two basic issues around definition of the relevant market. First, whether or not the relevant market should be restricted to carbonated soft drinks or whether competition should be judged across a market including other similar beverages such as mineral water, fruit juices, flavoured milks and other non-alcoholic drinks.

Interviews with executives in the industry revealed that pricing and marketing strategies generally took account of competition with other suppliers of CSDs rather than producers of a broader class of beverages. Internal marketing documents uncovered by the FTC's requests for information confirmed these impressions. Further, econometric studies of the retail prices of CSDs suggested that CSD sellers could, collectively, exercise market power.

The second issue was whether or not the flavouring concentrate used to make CSDs could be considered as a separate market. The large national CSD producers like Coca-Cola, Pepsi, Dr Pepper and Seven-Up were most importantly manufacturers of this concentrate. They sold the concentrated flavouring to independent local bottlers who added carbonated water and sweeteners and then packaged the beverages. These bottlers also provided distribution services for the finished products as well as supplying syrup (concentrate with the sweeteners added) to restaurants and other outlets with equipment to add the carbonated water on site.

The agreements between sellers of concentrate and the bottlers generally restricted each bottler to a local geographic area. They also prohibited an individual bottler from handling a competitor's brand if that competitor's concentrate had a similar flavour (so that the same bottler might handle Coca-Cola and Seven-Up, but never Coca-Cola and Pepsi or Royal Crown Cola).

The CSD-concentrate producers also had primary responsibility for marketing to end-consumers and were able to influence prices directly (through specific rebates and promotions).

Given this industry structure, the FTC felt it was reasonable to apply the Department of Justice guidelines to test whether CSD concentrate was a separate market; namely: that a 5% increase in price would be jointly profitable for the concentrate manufacturers. Based on interviews, the FTC satisfied itself that, in fact, a 10% increase in prices by CSD-concentrate producers could be sustained without being thwarted by consumers switching to other beverages if these producers were able to act collectively.

The conclusion that CSD concentrate was a separate market for antitrust purposes was strengthened by further evidence that there was little room to substitute other inputs for concentrate at the manufacturing stage and the CSD concentrate was a relatively small fraction of the retail price of the CSDs (approximately 10%).

[1] See White, L. J., in Kwoka, J. E. and White, L. J. (eds) (1989), *The antitrust revolution*, New York, Harper Collins, Chapter 3.

3. Applying the proposed initial merger screen

Our proposed concentration test based on C_4 finds that over 75% of the US retail market is accounted for by the brands of the four leading producers of CSD concentrate at the time of the case — well above our suggested 50% threshold (see Table 8).

In this case the US merger guidelines would have produced the same result since the proposed merger would have led to an increase in HHI of 341 points to reach 2 646 (well above the 1 800 threshold).

Detailed data on the past evolution of market share among the leading brands did not play a central role in the actual case, but estimates of stability of market shares computed from alternative sources suggest a relevant share instability (RSI) well below the average of the Caves-Porter benchmark sample.[1] Thus, both dimensions of our initial merger screen suggest that this proposed transaction warrants more detailed investigation.

Table 8

US retail sales of CSDs — Shares of leading CSD-concentrate producers, 1985

(%)

Producer		Share
Coca-Cola Co.		37,4
PepsiCo		28,9
Philip Morris (Seven-Up)		5,7
Dr Pepper Co.		4,6
R. J. Reynolds (Sunkist, Canada Dry)		3,0
Royal Crown Cola		2,9
Procter & Gamble (Orange Crush, Hines Root Beer)		1,8
Others (including private label)		15,7
	Total	100,0

Source: FTC v *Coca-Cola Co.*, 641 F. Supp.

4. The coordinated action test

A linchpin of Coca-Cola's defence was its contention that the characteristics of the CSD industry made it difficult to sustain any coordinated action to raise prices.

1 See 'Coke versus Pepsi: The cola wars', Harvard Business School, Case No 9-87-031, 1987.

4.1. Product heterogeneity

Coca-Cola argued that there were too many product types and sizes in the CSD market to support effective tacit coordination on price.

This argument is, however, quite doubtful. A proliferation across a product line does not necessarily add to the difficulty of tacit price coordination if the differences between the products are stable and can be assessed objectively. In this case, coordination on the price of a representative base product could set a framework for coordination across the whole range because the prices of individual varieties would be a stable and known multiple of this base price.

Product heterogeneity makes oligopolistic coordination difficult when it is associated with uncertain, volatile or subjective differences between products (such as subjective quality differences). These make it difficult to assess whether any change in the base product should be magnified or dampened in setting the prices of other related products.

4.2. Focal point pricing

Coca-Cola also argued that there were too many opportunities for concealed discounting for oligopolistic coordination to flourish. It would be difficult for any one oligopolist to monitor and police the others in any informal understanding to raise prices or reduce promotional discounts.

This argument carries somewhat more weight in respect of the CSD-concentrate market under consideration. This is because the actual prices at which a concentrate manufacturer sells to his bottlers is not transparent to competitors. The market therefore lacks a good focal point around which to coordinate pricing.

4.3. Buyer concentration

The exclusive territories awarded to bottlers under their agreements with the CSD-concentrate suppliers limited the total number of possible buyers that could coexist in the market at any one time. But since each territory was generally limited to a local metropolitan district, there were some thousands of bottlers. The ratio of HHI_{Buyers} to $HHI_{Sellers}$ was therefore low.

Moreover, much of the bargaining power in the relationship resided with the CSD-concentrate manufacturers. This reflected the fact that a bottler risked a substantial reduction in share if it lost a major CSD brand. A CSD-concentrate manufacturer, meanwhile, could usually find another local bottler or a new entrant willing to take on a popular line of brands.

As a result, buyer power could not be expected to constrain any oligopolistic coordination among CSD-concentrate manufacturers.

4.4. Supplier diversity

As evident in Table 8, nearly two thirds of the market was accounted for by two competitors: Coca-Cola and PepsiCo. Both of these firms had a large proportion of their total sales in the CSD business. Thus, while they both undoubtedly aimed at expanding their respective market shares, neither could afford a sustained price war that would permanently impair margins. Such a price war might threaten the entire survival of their businesses — CSD was not a peripheral business that could be sacrificed. The same was true for Dr Pepper and Royal Crown Cola.

For two other significant competitors (Procter & Gamble and Philip Morris), by contrast, CSD was a relatively minor part of their corporate portfolios. Each could have afforded to sacrifice margins in a quest to build market share without serious consequences for the corporation as a whole.

Thus supplier diversity might have suggested sufficient divergence of incentives and goals as to make coordinated action difficult. However, past conduct in the industry suggested that these competitors, for whatever reason, had been unwilling to use aggressive pricing in the hope of winning significant share increases. Philip Morris had announced its desire to sell its Seven-Up subsidiary (and presumably wished to maintain its record of profitability for this reason), while Procter & Gamble had been content to let its market share hover around the 2% level.

4.5. Multipoint contact

While the major suppliers to the US CSD-concentrate market do not generally meet in other major product markets, they do come face to face as competitors in other geographic markets. This opens up possibilities for threats of retaliation in third markets which might facilitate oligopolistic coordination in the US market.

4.6. The coordinated action test — Summary

Coca-Cola's arguments that the structural characteristics of the US CSD-concentrate market were such that any coordinated behaviour to raise prices would not be possible was rejected by the US courts in the actual case. Likewise, the series of indicators in our proposed EC merger policy suggest that sustained oligopolistic coordination in the US CSD-concentrate market should be feasible.

Although the product line comprises a substantial number of varieties, the differences between them tend to be stable and objectively observable. Thus price coordination around a base product could provide a basis for price coordination across the full line. Buyer concentration, meanwhile, is low — and the bargaining power of buyers relative to CSD-concentrate manufacturers tends to be weak. There is unlikely to be a powerful countervailing force against oligopolistic coordination to increase prices. The presence of multimarket contact makes it more likely that the two dominant players would have credible threats of retaliation at their disposal should any one player refuse to follow a pricing move.

At the same time, it is true that oligopolistic coordination in the CSD-concentrate market is not necessarily straightforward. Most importantly, the market lacks transparency of prices between CSD-concentrate supplier and bottler. There is also a considerable degree of diversity across suppliers in the market. In particular it includes some firms, like Philip Morris and Procter & Gamble, who have the resources available to mount an extended fight for increased market share should they choose to do so. In the past, however, three firms have been content to maintain modest market shares and avoid price warfare.

5. The trade exposure test

It would be generally uneconomic to ship carbonated water and sugar syrup around the world (unless it was in some way perceived as differentiated — as in the case of mineral waters). However, CSD concentrate could be economically traded internationally.

The question of whether the US CSD-concentrate industry is exposed to competition through international trade therefore turns on the issue of access to US distribution.

In fact, the FTC noted that imports into the market were negligible at the time of the case. Barriers to entry into US distribution would appear to be an important reason for this.

First, analysis conducted in the course of the case suggested that to be an effective distributor, a bottler needed total sales (across all the brands it carried) of a miniumum of 10 to 20% of a local market.[1] Unless an important supplier could offer a bottler the minimum sales volume, virtually from day one, it would have to sell its brands to bottlers who were already handling the US CSD-concentrate producer's brands. But the non-competing flavour restrictions in the contracts between the US CSD-concentrate manufacturers and the bottlers would limit an import supplier to selling only those flavours not currently competing with established US suppliers.

Second, in the case of vending machines or the mixing machines (known as 'fountains') in restaurants and other food and beverage outlets, these have a limited number of buttons or stations (generally six to eight). Thus, unless an imported brand could convince these vendors they would increase their sales by dropping an established US brand and substituting the import, it could not access these distribution channels.

Barriers to distribution, therefore, effectively shield the US CSD-concentrate market from effective trade exposure.

6. The contestability test

An important plank of the FTC case against Coca-Cola was that meaningful entry into the US CSD-concentrate market (or even significant expansion by smaller firms) was: (a) costly, (b) risky and (c) time-consuming.

Coca-Cola, by contrast, argued that entry into the manufacture and sale of CSD concentrate was easy: there were no specialized resources involved in the production and sale of CSD concentrate; economies of scale were not significant; the development of a flavour did not present a barrier (especially as specialized 'flavour houses' could be contracted to undertake the necessary development); there was available spare capacity in bottling and distribution; and independent food brokers and beer distributors offered additional channel capacity.

Recall that the core of our test for market contestability was that, following a 5% increase in pre-merger prices, a new competitor could enter at viable scale with minimal sunk-cost investments. The CSD-concentrate market fails this test for a number of reasons.

First, the sunk costs involved in advertising and promotion to launch a new soft drink at a scale sufficient to provide effective competition to established brands were high. It was reported that in the early 1980s Seven-Up spent USD 57 million in the first two years for promotion of its 'Lite Cola' brand. Coca-Cola marketing documents indicated that the company intended to spend USD 44 million in the first year to launch a new 'Cherry Coke' and USD 42 million on its new Minute Maid brand.

These large sunk-cost investments could be avoided by a strategy of gradually rolling out a new soft drink, one regional market at a time. This process would need to extend over four to five years to avoid large sunk-cost investments. Even if successful, therefore, this entry strategy was unlikely to rapidly counteract the effects of oligopolistic dominance.

Second, new entrants would face the same distribution barriers discussed in respect of trade exposure above. These barriers would effectively restrict new entrants to offering flavours not already part of the established players' product lines. This could substantially reduce the effectiveness of new entry as a discipline on the prices charged by incumbents.

Again, new entrants could try to bypass the barriers associated with gaining entry to existing networks of bottlers and installed vending and fountain systems by appealing to other possible distribution channels (such as beer distributors and independent food brokers). But this channel segmentation would reduce the effectiveness of entry in countering oligopolistic coordination in the mainstream market.

Alternatively, new entrants could try to develop strong customer ('pull') demand quickly so as to encourage distributors to carry the new brand and wrest limited vending slots from incumbents. To do so, however, would require large investments in brand building and end-consumer promotion — thereby increasing the entrant's exposure to risky sunk-cost investments.

Overall, therefore, we would conclude that the CSD-concentrate market fails the contestability test (not withstanding Coca-Cola's contention that entry into the market is easy).

7. The efficiency test

Coca-Cola advanced the argument that by merging with Dr Pepper and consolidating overlapping operations it could achieve improved cost efficiencies. As with our other cases, however, concerns about post-merger oligopolistic dominance would lead us to doubt that these efficiency gains would be passed on to benefit final consumers. This proposed merger does not appear to fall into the narrow range in which large efficiency gains coincide with minimal risk of adverse consequences from oligopolistic dominance.

[1] See White, op. cit., p. 87.

8. The failing firm test

There was no suggestion that either firm would be forced to exit the market if the merger were not to proceed.

9. Summary discussion of the Coca-Cola/Dr Pepper case

On 31 July 1986, the judge in this case found in favour of the FTC. A key element of judgment was the loss of competition between Coca-Cola and Dr Pepper that would result from the proposed merger, as summed up in the following quotation from the transcript:

'The stark, unvarnished truth is that Dr Pepper brand has been a staunch effective competitor in the market, that Coca-Cola Company has tried to stifle it by developing its own pepper drink and by seeking to replace it with its new Cherry Coke brand in fountain accounts at considerable expense and that it has failed. It is now seeking to buy out its competitor.'[1]

The transcript does not suggest, however, that this concern related directly to the issue of oligopolistic dominance. Referring to the possibility of oligopolistic coordination, the judge stated:

'... there is no proof that the mere addition of Dr Pepper to Coca-Cola Company's line, standing alone, will trigger a foreseeable development of this kind. The present intensity of competition between Coca-Cola Company and PepsiCo does not seem likely to diminish in the immediate future.'[2]

Our proposal for a policy towards oligopolistic dominance takes a somewhat different stance towards this case. Some of the main differences and similarities are worth highlighting:

(i) The proposals we advanced presume that there is a priori a risk of adverse effects from oligopolistic dominance when concentration among the leading four producers is high (in this case over 75%) and/or there has been a past history of market share stability.

It may be that by adding a further 5,7% share (in the form of Dr Pepper) to Coca-Cola's existing 37,4% share the merger would not have substantially increased the risk of oligopolistic dominance with adverse consequences. But where the potential for oligopolistic dominance is already high, the proposed framework is weighted against any merger, with little regard for how much it further increases that risk. Whether this should be the stance is an important policy issue.

(ii) Whether the market structure was conducive to oligopolistic coordination or would impede it played an important role in the Coca-Cola defence, the FTC case, and our analysis following the proposed guidelines (although seemingly not in the US court's judgment). This case illustrates the importance of looking at a broad set of indicators and interpreting each one carefully to gain a sense of whether oligopolistic coordination would be sustainable.

At the same time, it clearly illustrates the fact that these indicators often give conflicting signals and each is open to various alternative interpretations, so that ultimately considerable (and sometimes subjective) judgment is required to reach a conclusion.

(iii) The actual case gave considerable weight to entry conditions. It implictly looked at entry in terms of the requirement for sunk-cost investments. Our case analysis using our proposed framework demonstrates that it is possible to take a more direct approach to consideration of sunk costs and contestability (as the 1992 US merger guidelines have done) and how this approach might help to tighten up the analysis of the rather loose 'easy entry' defences often put forward by parties promoting mergers.

Case-study 4: The proposed merger of Kingfisher plc and Dixons Group plc

1. Background and issues

In the cases we have examined so far, the post-merger firms would not have become the largest players in their respective markets. The proposed Kingfisher/Dixons merger differs in this respect: the post-merger entity would have controlled an estimated 26% of UK electrical goods retailing compared with a 9% share for its nearest rival.

One of the features that makes the case instructive for our current purposes is that the UK Monopolies and Mergers Commission (MMC) did not find a case against the merger on the grounds of single firm dominance. Despite the fact that the merger would create a new firm much larger than

[1] *FTC* v *Coca-Cola Co.*, 641 F. Supp. 1128, 1139 (1986).
[2] *FTC* v *Coca-Cola Co.*, op. cit., 1138.

its rivals, the MMC believed that if this post-merger firm tried to raise prices independently it would largely be constrained by competition.

Instead, the UK MMC's concern was that a combination of Kingfisher and Dixons would increase the likelihood of tacit price collusion among the remaining competitors to follow pricing leads from Kingfisher/Dixons. The MMC feared that the market would begin to exhibit oligopolistic behaviour whereby other competitors implicitly recognized price leadership from Kingfisher/Dixons and thankfully sheltered under the umbrella of their prices.

Other interesting aspects of the case include the possible relationships between pricing in geographically local markets and pricing by national players, as well as the impact of the behaviour of suppliers on the downstream competitive structure in retailing.

On 6 December 1989 Kingfisher plc, a large diversified UK retailing group, announced a bid for Dixons plc, a firm specialized in the retailing of a wide range of electrical and photographic equipment. The Dixon's Board rejected the bid as hostile. In January 1990 the proposed acquisition was referred to the UK Monopolies and Mergers Commission to examine whether or not the proposed combination of the electrical retailing interests of the two firms might be against the public interest.

During this inquiry, the following issues came to the fore:

(i) the definition of the market in terms of product groups;

(ii) the geographic segmentation of the market and, in particular, the relationship between local pricing and competition among national players;

(iii) entry conditions;

(iv) the likelihood of collusive price leadership emerging among the remaining competitors in the market, post-merger.

Retailing of electrical goods accounted for 18% of Kingfishers' total turnover, through its Comet subsidiary.

Dixons Stores Group (DSG), accounting for 62% of Dixons Group plc's total turnover, managed two chains of electrical retailers: Dixons and Currys. The stores of the Dixons chain sell brown goods including domestic electronic products and photographic goods and electronic office equipment (mainly to individuals and small businesses). The Currys chain of stores sell white goods, small electrical appliances and brown goods.

2. Market definition

While the UK Monopolies and Mergers Commission undertook some analysis of competition in the retailing of specific product groups (such as washing-machines and dishwashers), it rapidly concluded that the relevant dimension on which to assess the possibilities of consumer substitution was that of type of outlet rather than product type.

It therefore chose to define the market as the 'retail distribution of electrical goods'. Within this market definition were both electrical goods specialists and multiproduct competitors, such as department stores, catalogue retailers and variety stores. It noted that only a small percentage of consumers obtained their products from non-retail sources.

Thus they set aside the fact that the product lines of particular competitors only partly overlapped (presumably on the grounds that any given retail outlet could adjust its product line at relatively low cost).

The next issue related to the choice of a geographically local versus a national definition of the market. Here Kingfisher argued that the relevant competition takes place at the local level, stating that:

'The fact that Kingfisher is a national retailer of electronic goods, and will be the largest national retailer after the merger, will not in itself affect competition in the retailing market. The market in which consumers shop around and choose to purchase from one retail outlet rather than another is the local market ... Competition is conducted in the local market, where price and product comparisons can be made most effectively.'

The Monopolies and Mergers Commission did not accept the implications of this argument for market definition. Instead it held that:

'It is evident that for the great majority of shoppers, purchasing of electrical goods remains a local activity. On the other hand, the prices and conditions which shoppers face are in our view decisively influenced, if not determined, by forces operating at the national level. It is, in particular, Dixons, Currys and Comet which have created national chains. They have, further, emphasized the national nature of their activities by setting national prices and by advertising their stores and the prices of their products nationally.'[1]

[1] UK Monopolies and Mergers Commission, Report No Cm 1079, p. 64.

On this argument, the possibility of oligopolistic behaviour was related to the behaviour of the dominant national players who potentially recognized their mutual interdependence. It was held that the interaction of these players would determine the pricing framework for the vast majority of local markets.

3. The initial merger screen

The prospective four-firm concentration ratio for the UK electrical retailing industry was estimated to be 32% should the proposed merger proceed. This falls well below our suggested hurdle of 50%.

Computation of the RSI (relative share instability) index is complicated by a recent history of mergers prior to the case. This fact flags the need for an adjustment mechanism to be incorporated into the RSI calculation to take account of merger activity over the previous three years. One possible adjustment would involve combining the shares of all firms currently merged as if they had been united for the whole of the three-year period.

Even after making this adjustment, the RSI for this industry is more than one standard deviation above the Caves-Porter US benchmark (again, note that EC benchmarks would need to be computed). In other words, past market shares in this industry have been relatively unstable.

Thus, both of our measures in the initial screen suggest that the merger should be cleared without further analysis.

It is also worth noting that the US regulations-based HHI would similarly clear this merger: the HHI is less than 500 compared with a hurdle of 1 000 under which the US market concentration test would be 'unlikely to challenge the merger'.

Moreover our 'incentive to collude' indicator (which measures the increase in profitability of collusion post-merger compared with pre-merger) is low — suggesting little practical increase in the potential gains from collusion as a result of the merger.[1]

It is therefore doubly interesting that the UK Monopolies and Mergers Commission ultimately chose to block this proposed merger on public interest grounds.

At the heart of the MMC's decision to do so was a concern over possible collusive price leadership following the combination of the two largest (although hardly dominant) players.

To understand this decision we need to look beyond concentration and past stability of market shares to the structure of the market (something which would not have taken place under our proposals because the merger would have cleared the initial screen).

If we were to conclude that the MMC's concern was warranted, then this case would represent an instance where the desire to set a policy framework that provides for a rapid initial clearance allowed a potentially damaging merger to slip through. If, on the other hand, we were to doubt the MMC's finding in this case, it would vindicate the structure of our initial screening mechanism.

4. The MMC's views: risks of collusive price leadership

The possible risk of collusive price leadership, post-merger lies at the heart of the difference between the MMC's finding and the results of applying our initial merger screen (or indeed a version of the US HHI test).

At the core of the MMC's finding was the view that combining the largest and second-largest sellers (even though post-merger concentration would remain relatively modest) would significantly increase the chances of collusive price leadership pushing up margins in the industry whereas this was not possible while the two largest players remained under separate control. This stemmed from a belief that the two largest players already acted as price leaders, but that competition between them kept the 'leadership price' lower than would be the case if this competition were to be eliminated by merging the two.

Specifically the MMC noted in respect of Kingfisher (Comet) and Dixons (DSG):

'We accept the evidence from both manufacturers and competing retailers that the national prices fixed and nationally advertised by Kingfisher and DSG are carefully monitored by competitors, who set their own prices by reference to the Kingfisher/DSG price levels. One large retailer said that Comet and DSG were the price leaders in the market and that it had to respond to their initiatives (for example, during the price wars on VCRs between Comet and DSG in the autumn of 1987). Another major retailing group told us

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1 Recall that this indicator is defined as $\Delta ITC = (C_{4A}^2 - HHI_A) - (C_{4B}^2 - HHI_B)$ where A = post-merger and B = pre-merger.

that it daily checked the DSG/Comet prices; to remain competitive it had to match immediately any price reductions set by either company. A DSG survey indicated that competitors keenly watch DSG's and Comet's prices, though DSG's interpretation of the data was challenged by Kingfisher.'

The MMC argued that the market lacked other powerful actors (in the form of manufacturers or entrants) that might constrain a gradual increase in margins through collusive price leadership, post-merger. Quite to the contrary, in the case of manufacturers it maintained that if a combined Kingfisher/Dixons exerted increased purchasing power to drive down their costs, that some manufacturers might be forced to recoup these lost margins by increasing their selling prices to other retailers. This would render these retailers less competitive and make them more likely to follow any lead from the combined Kingfisher/Dixons to increase prices.

Moreover, while the MMC did not argue directly the case for high entry barriers to this industry, it pointed to the historic reluctance of other large retailers (specializing in food or clothing for example) to diversify into electrical retailing.

Based on these main arguments the MMC recommended that the merger should not be permitted. It also concluded that 'no effective remedies could be identified'.

5. The dissenting view

One of the members of the Monopolies and Mergers Commission, however, presented a dissenting view included in the final report.[1]

First, he argued that there was 'great flux in retailing' over the recent past and that this could be expected to continue in the future. He pointed to the volatile changes in share and the rapid growth of retailers who specialized by product and/or region. On this point he concluded 'I can see, therefore, no grounds for thinking that the competitive forces which are so powerful throughout British retailing will not, left to their own devices, keep the balance in favour of the consumer'.

The essence of the arguments parallels the implications of the RSI (instability of past market shares) in our initial merger screen: that in the past competition would appear to have been robust; even with two players substantially larger than their rivals, oligopolistic dominance did not emerge. And, at least judged on the basis of the relatively modest increase in concentration which would result from the merger, we could not expect the situation to change fundamentally.

The second main plank of the dissenting view concerned the power of manufacturers. Here it was pointed out that manufacturers played a significant role in setting retail prices and could be expected to continue to do so. They were powerful international firms ('a roll-call of the international industrial elite'). It would be 'inconceivable that they [these firms] should be held to ransom or denied share by any one retailer'. Moreover, these manufacturers held a credible threat of forward integration into retailing (as Sony had, in fact, done by establishing its own chain of stores).

As a result of this manufacturer power, if Kingfisher/Dixons tried to lead prices higher, improving retail margins while costing the manufacturers' volume, manufacturers would retaliate strongly through a variety of measures including selective price cuts designed to persuade certain retailers to break with tacit collusion on price in the quest for more volume, or through targeted forward integration.

6. Summary discussion of the Kingfisher/Dixons case

This case demonstrates the role of our proposed initial merger screen in enabling the authorities to clear a merger quickly where the risks of oligopolistic dominance appear to be low.

By using a combination of both a concentration test and an indicator of past market conduct (in the form of our market share instability index), the danger of wrongly clearing potentially damaging mergers is reduced. In this case, the merger would have been cleared on the basis of the proposed initial screen without further analysis. This decision accords with the line of argument presented in the dissenting view in the MMC report on the case. The difference is that our proposals reach this conclusion on the basis of summary indicators rather than a full analysis of the merger situation.

At the same time, this case reminds us that any initial merger screen based on summary indicators will not always produce

[1] Baillieu, C. C. 'Note of dissent', MMC Report No Cm 1079, pp. 70-72.

the correct result. If the majority view of the MMC is correct, and there is a substantial risk of collusive price leadership, post-merger (despite modest concentration and robust competition in the past), then our initial screen would fail to identify this.

Policy is therefore forced to make a trade-off between an acceptable probability of this kind of error and the need to screen a potentially large number of proposed mergers quickly and to focus resources on those where risks of damaging oligopolistic dominance are most severe.

Part C

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I

(Acts whose publication is obligatory)

COUNCIL REGULATION (EEC) No 4064/89

of 21 December 1989

on the control of concentrations between undertakings

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Articles 87 and 235 thereof,

Having regard to the proposal from the Commission (1),

Having regard to the opinion of the European Parliament (2),

Having regard to the opinion of the Economic and Social Committee (3),

Whereas, for the achievement of the aims of the Treaty establishing the European Economic Community, Article 3 (f) gives the Community the objective of instituting 'a system ensuring that competition in the common market is not distorted';

Whereas this system is essential for the achievement of the internal market by 1992 and its further development;

Whereas the dismantling of internal frontiers is resulting and will continue to result in major corporate re-organizations in the Community, particularly in the form of concentrations;

Whereas such a development must be welcomed as being in line with the requirements of dynamic competition and capable of increasing the competitiveness of European industry, improving the conditions of growth and raising the standard of living in the Community;

Whereas, however, it must be ensured that the process of re-organization does not result in lasting damage to competition; whereas Community law must therefore include provisions governing those concentrations which may significantly impede effective competition in the common market or in a substantial part of it;

Whereas Articles 85 and 86, while applicable, according to the case-law of the Court of Justice, to certain concentrations, are not, however, sufficient to cover all operations which may prove to be incompatible with the system of undistorted competition envisaged in the Treaty;

Whereas a new legal instrument should therefore be created in the form of a Regulation to permit effective monitoring of all concentrations from the point of view of their effect on the structure of competition in the Community and to be the only instrument applicable to such concentrations;

Whereas this Regulation should therefore be based not only on Article 87 but, principally, on Article 235 of the Treaty, under which the Community may give itself the additional powers of action necessary for the attainment of its objectives, and also with regard to concentrations on the markets for agricultural products listed in Annex II to the Treaty;

Whereas the provisions to be adopted in this Regulation should apply to significant structural changes the impact of which on the market goes beyond the national borders of any one Member State;

Whereas the scope of application of this Regulation should therefore be defined according to the geographical area of activity of the undertakings concerned and be limited by quantitative thresholds in order to cover those concentrations which have a Community dimension; whereas, at the end of an initial phase of the implementation of this Regulation, these thresholds should be reviewed in the light of the experience gained;

Whereas a concentration with a Community dimension exists where the aggregate turnover of the undertakings concerned exceeds given levels worldwide and throughout

(1) OJ No C 130, 19. 5. 1988, p. 4.
(2) OJ No C 309, 5. 12. 1988, p. 55.
(3) OJ No C 208, 8. 8. 1988, p. 11.

the Community and where at least two of the undertakings concerned have their sole or main fields of activities in different Member States or where, although the undertakings in question act mainly in one and the same Member State, at least one of them has substantial operations in at least one other Member State; whereas that is also the case where the concentrations are effected by undertakings which do not have their principal fields of activities in the Community but which have substantial operations there;

Whereas the arrangements to be introduced for the control of concentrations should, without prejudice to Article 90 (2) of the Treaty, respect the principle of non-discrimination between the public and the private sectors; whereas, in the public sector, calculation of the turnover of an undertaking concerned in a concentration needs, therefore, to take account of undertakings making up an economic unit with an independent power of decision, irrespective of the way in which their capital is held or of the rules of administrative supervision applicable to them;

Whereas it is necessary to establish whether concentrations with a Community dimension are compatible or not with the common market from the point of view of the need to preserve and develop effective competition in the common market; whereas, in so doing, the Commission must place its appraisal within the general framework of the achievement of the fundamental objectives referred to in Article 2 of the Treaty, including that of strengthening the Community's economic and social cohesion, referred to in Article 130a;

Whereas this Regulation should establish the principle that a concentration with a Community dimension which creates or strengthens a position as result of which effective competition in the common market or in a substantial part of it is significantly impeded is to be declared incompatible with the common market;

Whereas concentrations which, by reason of the limited market share of the undertakings concerned, are not liable to impede effective competition may be presumed to be compatible with the common market; whereas, without prejudice to Articles 85 and 86 of the Treaty, an indication to this effect exists, in particular, where the market share of the undertakings concerned does not exceed 25 % either in the common market or in a substantial part of it;

Whereas the Commission should have the task of taking all the decisions necessary to establish whether or not concentrations of a Community dimension are compatible with the common market, as well as decisions designed to restore effective competition;

Whereas to ensure effective control undertakings should be obliged to give prior notification of concentrations with a Community dimension and provision should be made for the suspension of concentrations for a limited period, and for the possibility of extending or waiving a suspension where necessary; whereas in the interests of legal certainty the validity of transactions must nevertheless be protected as much as necessary;

Whereas a period within which the Commission must initiate a proceeding in respect of a notified concentration and a period within which it must give a final decision on the compatibility or incompatibility with the common market of a notified concentration should be laid down;

Whereas the undertakings concerned must be accorded the right to be heard by the Commission as soon as a proceeding has been initiated; whereas the members of management and supervisory organs and recognized workers' representatives in the undertakings concerned, together with third parties showing a legitimate interest, must also be given the opportunity to be heard;

Whereas the Commission should act in close and constant liaison with the competent authorities of the Member States from which it obtains comments and information;

Whereas, for the purposes of this Regulation, and in accordance with the case-law of the Court of Justice, the Commission must be afforded the assistance of the Member States and must also be empowered to require information to be given and to carry out the necessary investigations in order to appraise concentrations;

Whereas compliance with this Regulation must be enforceable by means of fines and periodic penalty payments; whereas the Court of Justice should be given unlimited jurisdiction in that regard pursuant to Article 172 of the Treaty;

Whereas it is appropriate to define the concept of concentration in such a manner as to cover only operations bringing about a durable change in the structure of the undertakings concerned; whereas it is therefore necessary to exclude from the scope of this Regulation those operations which have as their object or effect the coordination of the competitive behaviour of independent undertakings, since such operations fall to be examined under the appropriate provisions of Regulations implementing Article 85 or Article 86 of the Treaty; whereas it is appropriate to make this distinction specifically in the case of the creation of joint ventures;

Whereas there is no coordination of competitive behaviour within the meaning of this Regulation where two or more undertakings agree to acquire jointly control of one or more other undertakings with the object and effect of sharing amongst themselves such undertakings or their assets;

Whereas the application of this Regulation is not excluded where the undertakings concerned accept restrictions directly related and necessary to the implementation of the concentration;

Whereas the Commission should be given exclusive competence to apply this Regulation, subject to review by the Court of Justice;

Whereas the Member States may not apply their national legislation on competition to concentrations with a Community dimension, unless the Regulation makes provision therefor; whereas the relevant powers of national authorities should be limited to cases where, failing intervention by the Commission, effective competition is likely to be significantly impeded within the territory of a Member State and where the competition interests of that Member State cannot be sufficiently protected otherwise than by this Regulation; whereas the Member States concerned must act promptly in such cases; whereas this Regulation cannot, because of the diversity of national law, fix a single deadline for the adoption of remedies;

Whereas, furthermore, the exclusive application of this Regulation to concentrations with a Community dimension is without prejudice to Article 223 of the Treaty, and does not prevent the Member States' taking appropriate measures to protect legitimate interests other than those pursued by this Regulation, provided that such measures are compatible with the general principles and other provisions of Community law;

Whereas concentrations not referred to in this Regulation come, in principle, within the jurisdiction of the Member States; whereas, however, the Commission should have the power to act, at the request of a Member State concerned, in cases where effective competition would be significantly impeded within that Member State's territory;

Whereas the conditions in which concentrations involving Community undertakings are carried out in non-member countries should be observed, and provision should be made for the possibility of the Council's giving the Commission an appropriate mandate for negotiation with a view to obtaining non-discriminatory treatment for Community undertakings;

Whereas this Regulation in no way detracts from the collective rights of workers as recognized in the undertakings concerned,

HAS ADOPTED THIS REGULATION:

Article 1

Scope

1. Without prejudice to Article 22 this Regulation shall apply to all concentrations with a Community dimension as defined in paragraph 2.

2. For the purposes of this Regulation, a concentration has a Community dimension where;

(a) the aggregate worldwide turnover of all the undertakings concerned is more than ECU 5 000 million, and

(b) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than ECU 250 million,

unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

3. The thresholds laid down in paragraph 2 will be reviewed before the end of the fourth year following that of the adoption of this Regulation by the Council acting by a qualified majority on a proposal from the Commission.

Article 2

Appraisal of concentrations

1. Concentrations within the scope of this Regulation shall be appraised in accordance with the following provisions with a view to establishing whether or not they are compatible with the common market.

In making this appraisal, the Commission shall take into account:

(a) the need to preserve and develop effective competition within the common market in view of, among other things, the structure of all the markets concerned and the actual or potential competition from undertakings located either within or without the Community;

(b) the market position of the undertakings concerned and their economic and financial power, the opportunities available to suppliers and users, their access to supplies or markets, any legal or other barriers to entry, supply and demand trends for the relevant goods and services, the interests of the intermediate and ultimate consumers, and the development of technical and economic progress provided that it is to consumers' advantage and does not form an obstacle to competition.

2. A concentration which does not create or strengthen 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 compatible with the common market.

3. 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.

Article 3

Definition of concentration

1. A concentration shall be deemed to arise where:

(a) two or more previously independent undertakings merge, or

(b) one or more persons already controlling at least one undertaking, or

— one or more undertakings

acquire, whether by purchase of securities or assets, by contract or by any other means, direct or indirect control of the whole or parts of one or more other undertakings.

2. An operation, including the creation of a joint venture, which has as its object or effect the coordination of the competitive behaviour of undertakings which remain independent shall not constitute a concentration within the meaning of paragraph 1 (b).

The creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity, which does not give rise to coordination of the competitive behaviour of the parties amongst themselves or between them and the joint venture, shall constitute a concentration within the meaning of paragraph 1 (b).

3. For the purposes of this Regulation, control shall be constituted by rights, contracts or any other means which, either separately or jointly and having regard to the considerations of fact or law involved, confer the possibility of exercising decisive influence on an undertaking, in particular by:

(a) ownership or the right to use all or part of the assets of an undertaking;

(b) rights or contracts which confer decisive influence on the composition, voting or decisions of the organs of an undertaking.

4. Control is acquired by persons or undertakings which:

(a) are holders of the rights or entitled to rights under the contracts concerned, or

(b) while not being holders of such rights or entitled to rights under such contracts, have the power to exercise the rights deriving therefrom.

5. A concentration shall not be deemed to arise where:

(a) credit institutions or other financial institutions or insurance companies, the normal activities of which include transactions and dealing in securities for their own account or for the account of others, hold on a temporary basis securities which they have acquired in an undertaking with a view to reselling them, provided that they do not exercise voting rights in respect of those securities with a view to determining the competitive behaviour of that undertaking or provided that they exercise such voting rights only with a view to preparing the sale of all or part of that undertaking or of its assets or the sale of those securities and that any such sale takes place within one year of the date of acquisition; that period may be extended by the Commission on request where such institutions or companies justify the fact that the sale was not reasonably possible within the period set;

(b) control is acquired by an office holder according to the law of a Member State relating to liquidation, winding up, insolvency, cessation of payments, compositions or analogous proceedings;

(c) the operations referred to in paragraph 1 (b) are carried out by the financial holding companies referred to in Article 5 (3) of the Fourth Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies [1], as last amended by Directive 84/569/EEC [2], provided however that the voting rights in respect of the holding are exercised, in particular in relation to the appointment of members of the management and supervisory bodies of the undertakings in which they have holdings, only to maintain the full value of those investments and not to determine directly or indirectly the competitive conduct of those undertakings.

Article 4

Prior notification of concentrations

1. Concentrations with a Community dimension as referred to by this Regulation shall be notified to the Commission not more than one week after the conclusion of the agreement, or the announcement of the public bid, or the acquisition of a controlling interest. That week shall begin when the first of those events occurs.

2. A concentration which consists of a merger within the meaning of Article 3 (1) (a) or in the acquisition of joint control within the meaning of Article 3 (1) (b) shall be notified jointly by the parties to the merger or by those acquiring joint control as the case may be. In all other cases,

[1] OJ No L 222, 14. 8. 1978, p. 11.
[2] OJ No L 314, 4. 12. 1984, p. 28.

the notification shall be effected by the person or undertaking acquiring control of the whole or parts of one or more undertakings.

3. Where the Commission finds that a notified concentration falls within the scope of this Regulation, it shall publish the fact of the notification, at the same time indicating the names of the parties, the nature of the concentration and the economic sectors involved. The Commission shall take account of the legitimate interest of undertakings in the protection of their business secrets.

Article 5

Calculation of turnover

1. Aggregate turnover within the meaning of Article 1 (2) shall comprise the amounts derived by the undertakings concerned in the preceding financial year from the sale of products and the provision of services falling within the undertakings' ordinary activities after deduction of sales rebates and of value added tax and other taxes directly related to turnover. The aggregate turnover of an undertaking concerned shall not include the sale of products or the provision of services between any of the undertakings referred to in paragraph 4.

Turnover, in the Community or in a Member State, shall comprise products sold and services provided to undertakings or consumers, in the Community or in that Member State as the case may be.

2. By way of derogation from paragraph 1, where the concentration consists in the acquisition of parts, whether or not constituted as legal entities, of one or more undertakings, only the turnover relating to the parts which are the subject of the transaction shall be taken into account with regard to the seller or sellers.

However, two or more transactions within the meaning of the first subparagraph which take place within a two-year period between the same persons or undertakings shall be treated as one and the same concentration arising on the date of the last transaction.

3. In place of turnover the following shall be used:

(a) for credit institutions and other financial institutions, as regards Article 1 (2) (a), one-tenth of their total assets.

As regards Article 1 (2) (b) and the final part of Article 1 (2), total Community-wide turnover shall be replaced by one-tenth of total assets multiplied by the ratio between loans and advances to credit institutions and customers in transactions with Community residents and the total sum of those loans and advances.

As regards the final part of Article 1 (2), total turnover within one Member State shall be replaced by one-tenth of total assets multiplied by the ratio between loans and advances to credit institutions and customers in transactions with residents of that Member State and the total sum of those loans and advances;

(b) for insurance undertakings, the value of gross premiums written which shall comprise all amounts received and receivable in respect of insurance contracts issued by or on behalf of the insurance undertakings, including also outgoing reinsurance premiums, and after deduction of taxes and parafiscal contributions or levies charged by reference to the amounts of individual premiums or the total volume of premiums; as regards Article 1 (2) (b) and the final part of Article 1 (2), gross premiums received from Community residents and from residents of one Member State respectively shall be taken into account.

4. Without prejudice to paragraph 2, the turnover of an undertaking concerned within the meaning of Article 1 (2) shall be calculated by adding together the respective turnover of the following:

(a) the undertaking concerned;

(b) those undertakings in which the undertaking concerned, directly or indirectly;

— owns more than half the capital or business assets, or

— has the power to exercise more than half the voting rights, or

— has the power to appoint more than half the members of the supervisory board, the administrative board or bodies legally representing the undertakings, or

— has the right to manage the undertakings' affairs;

(c) those undertakings which have in an undertaking concerned the rights or powers listed in (b);

(d) those undertakings in which an undertaking as referred to in (c) has the rights or powers listed in (b);

(e) those undertakings in which two or more undertakings as referred to in (a) to (d) jointly have the rights or powers listed in (b).

5. Where undertakings concerned by the concentration jointly have the rights or powers listed in paragraph 4 (b), in calculating the turnover of the undertakings concerned for the purposes of Article 1 (2);

(a) no account shall be taken of the turnover resulting from the sale of products or the provision of services between the joint undertaking and each of the undertakings concerned or any other undertaking connected with any one of them, as set out in paragraph 4 (b) to (e);

(b) account shall be taken of the turnover resulting from the sale of products and the provision of services between the joint undertaking and any third undertakings. This turnover shall be apportioned equally amongst the undertakings concerned.

Article 6

Examination of the notification and initiation of proceedings

1. The Commission shall examine the notification as soon as it is received.

(a) Where it concludes that the concentration notified does not fall within the scope of this Regulation, it shall record that finding by means of a decision.

(b) Where it finds that the concentration notified, although falling within the scope of this Regulation, does not raise serious doubts as to its compatibility with the common market, it shall decide not to oppose it and shall declare that it is compatible with the common market.

(c) If, on the other hand, it finds that the concentration notified falls within the scope of this Regulation and raises serious doubts as to its compatibility with the common market, it shall decide to initiate proceedings.

2. The Commission shall notify its decision to the undertakings concerned and the competent authorities of the Member States without delay.

Article 7

Suspension of concentrations

1. For the purposes of paragraph 2 a concentration as defined in Article 1 shall not be put into effect either before its notification or within the first three weeks following its notification.

2. Where the Commission, following a preliminary examination of the notification within the period provided for in paragraph 1, finds it necessary in order to ensure the full effectiveness of any decision taken later pursuant to Article 8 (3) and (4), it may decide on its own initiative to continue the suspension of a concentration in whole or in part until it takes a final decision, or to take other interim measures to that effect.

3. Paragraphs 1 and 2 shall not impede the implementation of a public bid which has been notified to the Commission in accordance with Article 4 (1) by the date of its announcement, provided that the acquirer does not exercise the voting rights attached to the securities in question or does so only to maintain the full value of those investments and on the basis of a derogation granted by the Commission pursuant to paragraph 4.

4. The Commission may, on request, grant a derogation from the obligations imposed in paragraphs 1, 2 or 3 in order to prevent serious damage to one or more undertakings concerned by a concentration or to a third party. That derogation may be made subject to conditions and obligations in order to ensure conditions of effective competition. A derogation may be applied for and granted at any time, even before notification or after the transaction.

5. The validity of any transaction carried out in contravention of paragraph 1 or 2 shall be dependent on a decision pursuant to Article 6 (1) (b) or 8 (2) or (3) or by virtue of the presumption established by Article 10 (6).

This Article shall, however, have no effect on the validity of transactions in securities including those convertible into other securities admitted to trading on a market which is regulated and supervised by authorities recognized by public bodies, operates regularly and is accessible directly or indirectly to the public, unless the buyer and seller knew or ought to have known that the transaction was carried out in contravention of paragraph 1 or 2.

Article 8

Powers of decision of the Commission

1. Without prejudice to Article 9, each proceeding initiated pursuant to Article 6 (1) (c) shall be closed by means of a decision as provided for in paragraphs 2 to 5.

2. Where the Commission finds that, following modification by the undertakings concerned if necessary, a notified concentration fulfils the criterion laid down in Article 2 (2), it shall issue a decision declaring the concentration compatible with the common market.

It may attach to its decision conditions and obligations intended to ensure that the undertakings concerned comply with the commitments they have entered into *vis-à-vis* the Commission with a view to modifying the original concentration plan. The decision declaring the concentration compatible shall also cover restrictions directly related and necessary to the implementation of the concentration.

3. Where the Commission finnds that a concentration fulfils the criterion laid down in Article 2 (3), it shall issue a decision declaring that the concentration is incompatible with the common market.

4. Where a concentration has already been implemented, the Commission may, in a decision pursuant to paragraph 3 or by a separate decision, require the undertakings or assets brought together to be separated or the cessation of joint

control or any other action that may be appropriate in order to restore conditions of effective competition.

5. The Commission may revoke the decision it has taken pursuant to paragraph 2 where:

(a) the declaration of compatibility is based on incorrect information for which one of the undertakings concerned is responsible or where it has been obtained by deceit, or

(b) the undertakings concerned commit a breach of an obligation attached to the decision.

6. In the case referred to in paragraph 5, the Commission may take a decision pursuant to paragraph 3, without being bound by the deadline referred to in Article 10 (3).

Article 9

Referral to the competent authorities of the Member States

1. The Commission may, by means of a decision notified without delay to the undertakings concerned and the competent authorities of the other Member States, refer a notified concentration to the competent authorities of the Member State concerned in the following circumstances.

2. Within three weeks of the date of receipt of the copy of the notification a Member State may inform the Commission which shall inform the undertakings concerned that a concentration threatens to create or to strengthen a dominant position as a result of which effective competition would be significantly impeded on a market, within that Member State, which presents all the characteristics of a distinct market, be it a substantial part of the common market or not.

3. If the Commission considers that, having regard to the market for the products or services in question and the geographical reference market within the meaning of paragraph 7, there is such a distinct market and that such a threat exists either:

(a) it shall itself deal with the case in order to maintain or restore effective competition on the market concerned, or

(b) it shall refer the case to the competent authorities of the Member State concerned with a view to the application of that State's national competition law.

If, however, the Commission considers that such a distinct market or threat does not exist it shall adopt a decision to that effect which it shall address to the Member State concerned.

4. A decision to refer or not to refer pursuant to paragraph 3 shall be taken where:

(a) as a general rule within the six-week period provided for in Article 10 (1), second subparagraph, where the Commission has not initiated proceedings pursuant to Article 6 (1) (b), or

(b) within three months at most of the notification of the concentration concerned where the Commission has initiated proceedings under Article 6 (1) (c), without taking the preparatory steps in order to adopt the necessary measures pursuant to Article 8 (2), second subparagraph, (3) or (4) to maintain or restore effective competition on the market concerned.

5. If within the three months referred to in paragraph 4 (b) the Commission, despite a reminder from the Member State concerned, has taken no decision on referral in accordance with paragraph 3 or taken the preparatory steps referred to in paragraph 4 (b), it shall be deemed to have taken a decision to refer the case to the Member State concerned in accordance with paragraph 3 (b).

6. The publication of any report or the announcement of the findings of the examination of the concentration by the competent authority of the Member State concerned shall be effected not more than four months after the Commission's referral.

7. The geographical reference market shall consist of the area in which the undertakings concerned are involved in the supply of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because, in particular, conditions of competition are appreciably different in those areas. This assessment should take account in particular of the nature and characteristics of the products or services concerned, of the existence of entry barriers or of consumer preferences, of appreciable differences of the undertakings' market shares between neighbouring areas or of substantial price differences.

8. In applying the provisions of this Article, the Member State concerned may take only the measures strictly necessary to safeguard or restore effective competition on the market concerned.

9. In accordance with the relevant provisions of the Treaty, any Member State may appeal to the Court of Justice, and in particular request the application of Article 186, for the purpose of applying its national competition law.

10. This Article will be reviewed before the end of the fourth year following that of the adoption of this Regulation.

Article 10

Time limits for initiating proceedings and for decisions

1. The decisions referred to in Article 6 (1) must be taken within one month at most. That period shall begin on the day following the receipt of a notification or, if the information to be supplied with the notification is incomplete, on the day following the receipt of the complete information.

That period shall be increased to six weeks if the Commission receives a request from a Member State in accordance with Article 9 (2).

2. Decisions taken pursuant to Article 8 (2) concerning notified concentrations must be taken as soon as it appears that the serious doubts referred to in Article 6 (1) (c) have been removed, particularly as a result of modifications made by the undertakings concerned, and at the latest by the deadline laid down in paragraph 3.

3. Without prejudice to Article 8 (6), decisions taken pursuant to Article 8 (3) concerning notified concentrations must be taken within not more than four months of the date on which the proceeding is initiated.

4. The period set by paragraph 3 shall exceptionally be suspended where, owing to circumstances for which one of the undertakings involved in the concentration is responsible, the Commission has had to request information by decision pursuant to Article 11 or to order an investigation by decision pursuant to Article 13.

5. Where the Court of Justice gives a judgment which annuls the whole or part of a Commission decision taken under this Regulation, the periods laid down in this Regulation shall start again from the date of the judgment.

6. Where the Commission has not taken a decision in accordance with Article 6 (1) (b) or (c) or Article 8 (2) or (3) within the deadlines set in paragraphs 1 and 3 respectively, the concentration shall be deemed declared compatible with the common market, without prejudice to Article 9.

Article 11

Requests for information

1. In carrying out the duties assigned to it by this Regulation, the Commission may obtain all necessary information from the Governments and competent authorities of the Member States, from the persons referred to in Article 3 (1) (b), and from undertakings and associations of undertakings.

2. When sending a request for information to a person, an undertaking or an association of undertakings, the Commission shall at the same time send a copy of the request to the competent authority of the Member State within the territory of which the residence of the person or the seat of the undertaking or association of undertakings is situated.

3. In its request the Commission shall state the legal basis and the purpose of the request and also the penalties provided for in Article 14 (1) (b) for supplying incorrect information.

4. The information requested shall be provided, in the case of undertakings, by their owners or their representatives and, in the case of legal persons, companies or firms, or of associations having no legal personality, by the persons authorized to represent them by law or by their statutes.

5. Where a person, an undertaking or an association of undertakings does not provide the information requested within the period fixed by the Commission or provides incomplete information, the Commission shall by decision require the information to be provided. The decision shall specify what information is required, fix an appropriate period within which it is to be supplied and state the penalties provided for in Articles 14 (1) (b) and 15 (1) (a) and the right to have the decision reviewed by the Court of Justice.

6. The Commission shall at the same time send a copy of its decision to the competent authority of the Member State within the territory of which the residence of the person or the seat of the undertaking or association of undertakings is situated.

Article 12

Investigations by the authorities of the Member States

1. At the request of the Commission, the competent authorities of the Member States shall undertake the investigations which the Commission considers to be necessary pursuant to Article 13 (1), or which it has ordered by decision pursuant to Article 13 (3). The officials of the competent authorities of the Member States responsible for conducting those investigations shall exercise their powers upon production of an authorization in writing issued by the competent authority of the Member State within the territory of which the investigation is to be carried out. Such authorization shall specify the subject matter and purpose of the investigation.

2. If so requested by the Commission or by the competent authority of the Member State within the territory of which the investigation is to be carried out, officials of the Commission may assist the officials of that authority in carrying out their duties.

Article 13

Investigative powers of the Commission

1. In carrying out the duties assigned to it by this Regulation, the Commission may undertake all necessary investigations into undertakings and associations of undertakings.

To that end the officials authorized by the Commission shall be empowered:

(a) to examine the books and other business records;

(b) to take or demand copies of or extracts from the books and business records;

(c) to ask for oral explanations on the spot;

(d) to enter any premises, land and means of transport of undertakings.

2. The officials of the Commission authorized to carry out the investigations shall exercise their powers on production of an authorization in writing specifying the subject matter and purpose of the investigation and the penalties provided for in Article 14 (1) (c) in cases where production of the required books or other business records is incomplete. In good time before the investigation, the Commission shall inform, in writing, the competent authority of the Member State within the territory of which the investigation is to be carried out of the investigation and of the identities of the authorized officials.

3. Undertakings and associations of undertakings shall submit to investigations ordered by decision of the Commission. The decision shall specify the subject matter and purpose of the investigation, appoint the date on which it shall begin and state the penalties provided for in Articles 14 (1) (c) and 15 (1) (b) and the right to have the decision reviewed by the Court of Justice.

4. The Commission shall in good time and in writing inform the competent authority of the Member State within the territory of which the investigation is to be carried out of its intention of taking a decision pursuant to paragraph 3. It shall hear the competent authority before taking its decision.

5. Officials of the competent authority of the Member State within the territory of which the investigation is to be carried out may, at the request of that authority or of the Commission, assist the officials of the Commission in carrying out their duties.

6. Where an undertaking or association of undertakings opposes an investigation ordered pursuant to this Article, the Member State concerned shall afford the necessary assistance to the officials authorized by the Commission to enable them to carry out their investigation. To this end the Member States shall, after consulting the Commission, take the necessary measures within one year of the entry into force of this Regulation.

Article 14

Fines

1. The Commission may by decision impose on the persons referred to in Article 3 (1) (b), undertakings or associations of undertakings fines of from ECU 1 000 to 50 000 where intentionally or negligently:

(a) they omit to notify a concentration in accordance with Article 4;

(b) they supply incorrect or misleading information in a notification pursuant to Article 4;

(c) they supply incorrect information in response to a request made pursuant to Article 11 or fail to supply information within the period fixed by a decision taken pursuant to Article 11;

(d) they produce the required books or other business records in incomplete form during investigations pursuant to Article 12 or 13, or refuse to submit to an investigation ordered by decision taken pursuant to Article 13.

2. The Commission may by decision impose fines not exceeding 10% of the aggregate turnover of the undertakings concerned within the meaning of Article 5 on the persons or undertakings concerned where, either intentionally or negligently, they;

(a) fail to comply with an obligation imposed by decision pursuant to Article 7 (4) or 8 (2), second subparagraph;

(b) put into effect a concentration in breach of Article 7 (1) or disregard a decision taken pursuant to Article 7 (2);

(c) put into effect a concentration declared incompatible with the common market by decision pursuant to Article 8 (3) or do not take the measures ordered by decision pursuant to Article 8 (4).

3. In setting the amount of a fine, regard shall be had to the nature and gravity of the infringement.

4. Decisions taken pursuant to paragraphs 1 and 2 shall not be of a criminal law nature.

Article 15

Periodic penalty payments

1. The Commission may by decision impose on the persons referred to in Article 3 (1) (b), undertakings or associations of undertakings concerned periodic penalty payments of up to ECU 25 000 for each day of the delay calculated from the date set in the decision, in order to compel them:

(a) to supply complete and correct information which it has requested by decision pursuant to Article 11;

(b) to submit to an investigation which it has ordered by decision pursuant to Article 13.

2. The Commission may by decision impose on the persons referred to in Article 3 (1) (b) or on undertakings

periodic penalty payments of up to ECU 100 000 for each day of the delay calculated from the date set in the decision, in order to compel them:

(a) to comply with an obligation imposed by decision pursuant to Article 7 (4) or 8 (2), second subparagraph, or

(b) to apply the measures ordered by decision pursuant to Article 8 (4).

3. Where the persons referred to in Article 3 (1) (b), undertakings or associations of undertakings have satisfied the obligation which it was the purpose of the periodic penalty payment to enforce, the Commission may set the total amount of the periodic penalty payments at a lower figure than that which would arise under the original decision.

Article 16

Review by the Court of Justice

The Court of Justice shall have unlimited jurisdiction within the meaning of Article 172 of the Treaty to review decisions whereby the Commission has fixed a fine or periodic penalty payments; it may cancel, reduce or increase the fine or periodic penalty payment imposed.

Article 17

Professional secrecy

1. Information acquired as a result of the application of Articles 11, 12, 13 and 18 shall be used only for the purposes of the relevant request, investigation or hearing.

2. Without prejudice to Articles 4 (3), 18 and 20, the Commission and the competent authorities of the Member States, their officials and other servants shall not disclose information they have acquired through the application of this Regulation of the kind covered by the obligation of professional secrecy.

3. Paragraphs 1 and 2 shall not prevent publication of general information or of surveys which do not contain information relating to particular undertakings or associations of undertakings.

Article 18

Hearing of the parties and of third persons

1. Before taking any decision provided for in Article 7 (2) and (4), 8 (2), second subparagraph, and (3) to (5), 14 and 15, the Commission shall give the persons, undertakings and associations of undertakings concerned the opportunity, at every stage of the procedure up to the consultation of the Advisory Committee, of making known their views on the objections against them.

2. By way of derogation from paragraph 1, a decision to continue the suspension of a concentration or to grant a derogation from suspension as referred to in Article 7 (2) or (4) may be taken provisionally, without the persons, undertakings or associations of undertakings concerned being given the opportunity to make known their views beforehand, provided that the Commission gives them that opportunity as soon as possible after having taken its decision.

3. The Commission shall base its decision only on objections on which the parties have been able to submit their observations. The rights of the defence shall be fully respected in the proceedings. Access to the file shall be open at least to the parties directly involved, subject to the legitimate interest of undertakings in the protection of their business secrets.

4. Insofar as the Commission and the competent authorities of the Member States deem it necessary, they may also hear other natural or legal persons. Natural or legal persons showing a legitimate interest and especially members of the administrative or management organs of the undertakings concerned or recognized workers' representatives of those undertakings shall be entitled, upon application, to be heard.

Article 19

Liaison with the authorities of the Member States

1. The Commission shall transmit to the competent authorities of the Member States copies of notifications within three working days and, as soon as possible, copies of the most important documents lodged with or issued by the Commission pursuant to this Regulation.

2. The Commission shall carry out the procedures set out in this Regulation in close and constant liaison with the competent authorities of the Member States, which may express their views upon those procedures. For the purposes of Article 9 it shall obtain information from the competent authority of the Member State as referred to in paragraph 2 of that Article and give it the opportunity to make known its views at every stage of the procedure up to the adoption of a decision pursuant to paragraph 3 of that Article; to that end it shall give it access to the file.

3. An Advisory Committee on concentrations shall be consulted before any decision is taken pursuant to Articles 8 (2) to (5), 14 or 15, or any provisions are adopted pursuant to Article 23.

4. The Advisory Committee shall consist of representatives of the authorities of the Member States. Each Member State shall appoint one or two representatives; if

unable to attend, they may be replaced by other representatives. At least one of the representatives of a Member State shall be competent in matters of restrictive practices and dominant positions.

5. Consultation shall take place at a joint meeting convened at the invitation of and chaired by the Commission. A summary of the facts, together with the most important documents and a preliminary draft of the decision to be taken for each case considered, shall be sent with the invitation. The meeting shall take place not less than 14 days after the invitation has been sent. The Commission may in exceptional cases shorten that period as appropriate in order to avoid serious harm to one or more of the undertakings concerned by a concentration.

6. The Advisory Committee shall deliver an opinion on the Commission's draft decision, if necessary by taking a vote. The Advisory Committee may deliver an opinion even if some members are absent and unrepresented. The opinion shall be delivered in writing and appended to the draft decision. The Commission shall take the utmost account of the opinion delivered by the Committee. It shall inform the Committee of the manner in which its opinion has been taken into account.

7. The Advisory Committee may recommend publication of the opinion. The Commission may carry out such publication. The decision to publish shall take due account of the legitimate interest of undertakings in the protection of their business secrets and of the interest of the undertakings concerned in such publication taking place.

Article 20

Publication of decisions

1. The Commission shall publish the decisions which it takes pursuant to Article 8 (2), where conditions and obligations are attached to them, and to Article 8 (2) to (5) in the Official Journal of the European Communities.

2. The publication shall state the names of the parties and the main content of the decision; it shall have regard to the legitimate interest of undertakings in the protection of their business secrets.

Article 21

Jurisdiction

1. Subject to review by the Court of Justice, the Commission shall have sole competence to take the decisions provided for in this Regulation.

2. No Member State shall apply its national legislation on competition to any concentration that has a Community dimension.

The first subparagraph shall be without prejudice to any Member State's power to carry out any enquiries necessary for the application of Article 9 (2) or after referral, pursuant to Article 9 (3), first subparagraph, indent (b), or (5), to take the measures strictly necessary for the application of Article 9 (8).

3. Notwithstanding paragraphs 1 and 2, Member States may take appropriate measures to protect legitimate interests other than those taken into consideration by this Regulation and compatible with the general principles and other provisions of Community law.

Public security, plurality of the media and prudential rules shall be regarded as legitimate interests within the meaning of the first subparagraph.

Any other public interest must be communicated to the Commission by the Member State concerned and shall be recognized by the Commission after an assessment of its compatibility with the general principles and other provisions of Community law before the measures referred to above may be taken. The Commission shall inform the Member State concerned of its decision within one month of that communication.

Article 22

Application of the Regulation

1. This Regulation alone shall apply to concentrations as defined in Article 3.

2. Regulations No 17 [1], (EEC) No 1017/68 [2], (EEC) No 4056/86 [3] and (EEC) No 3975/87 [4] shall not apply to concentrations as defined in Article 3.

3. If the Commission finds, at the request of a Member State, that a concentration as defined in Article 3 that has no Community dimension within the meaning of Article 1 creates or strengthens a dominant position as a result of which effective competition would be significantly impeded within the territory of the Member State concerned it may, insofar as the concentration affects trade between Member States, adopt the decisions provided for in Article 8 (2), second subparagraph, (3) and (4).

4. Articles 2 (1) (a) and (b), 5, 6, 8 and 10 to 20 shall apply. The period within which the proceedings defined in Article 10 (1) may be initiated shall begin on the date of the receipt of the request from the Member State. The request must be made within one month at most of the date on which the concentration was made known to the Member State or effected. This period shall begin on the date of the first of those events.

5. Pursuant to paragraph 3 the Commission shall take only the measures strictly necessary to maintain or restore

(1) OJ No 13, 21. 2. 1962, p. 204/62.
(2) OJ No L 175, 23. 7. 1968, p. 1.
(3) OJ No L 378, 31. 12. 1986, p. 4.
(4) OJ No L 374, 31. 12. 1987, p. 1.

effective competition within the territory of the Member State at the request of which it intervenes.

6. Paragraphs 3 to 5 shall continue to apply until the thresholds referred to in Article 1 (2) have been reviewed.

Article 23

Implementing provisions

The Commission shall have the power to adopt implementing provisions concerning the form, content and other details of notifications pursuant to Article 4, time limits pursuant to Article 10, and hearings pursuant to Article 18.

Article 24

Relations with non-member countries

1. The Member States shall inform the Commission of any general difficulties encountered by their undertakings with concentrations as defined in Article 3 in a non-member country.

2. Initially not more than one year after the entry into force of this Regulation and thereafter periodically the Commission shall draw up a report examining the treatment accorded to Community undertakings, in the terms referred to in paragraphs 3 and 4, as regards concentrations in non-member countries. The Commission shall submit those reports to the Council, together with any recommendations.

3. Whenever it appears to the Commission, either on the basis of the reports referred to in paragraph 2 or on the basis of other information, that a non-member country does not grant Community undertakings treatment comparable to that granted by the Community to undertakings from that non-member country, the Commission may submit proposals to the Council for the appropriate mandate for negotiation with a view to obtaining comparable treatment for Community undertakings.

4. Measures taken pursuant to this Article shall comply with the obligations of the Community or of the Member States, without prejudice to Article 234 of the Treaty, under international agreements, whether bilateral or multilateral.

Article 25

Entry into force

1. This Regulation shall enter into force on 21 September 1990.

2. This Regulation shall not apply to any concentration which was the subject of an agreement or announcement or where control was acquired within the meaning of Article 4 (1) before the date of this Regulation's entry into force and it shall not in any circumstances apply to any concentration in respect of which proceedings were initiated before that date by a Member State's authority with responsibility for competition.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 21 December 1989.

For the Council

The President

E. CRESSON

CORRIGENDA

Corrigendum to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings

(Official Journal of the European Communities No L 395 of 30 December 1990)

Given that certain errors appear in the various language versions of the abovementioned Regulation, the entire text shall be published as below in the form of a corrected version replacing the version of the Regulation published in *Official Journal of the European Communities* No L 395 of 30 December 1989, page 1.

***Note:* The statements entered in the Council minutes relating to this Regulation will be published later in the *Official Journal of the European Communities*.**

II

(Acts whose publication is not obligatory)

COUNCIL AND COMMISSION

DECISION OF THE COUNCIL AND THE COMMISSION

of 13 December 1993

on the conclusion of the Agreement on the European Economic Area between the European Communities, their Member States and the Republic of Austria, the Republic of Finland, the Republic of Iceland, the Principality of Liechtenstein, the Kingdom of Norway, the Kingdom of Sweden and the Swiss Confederation

(94/1/ECSC, EC)

THE COUNCIL OF THE EUROPEAN UNION,

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Coal and Steel Community,

Having regard to the Treaty establishing the European Community, and in particular Article 238 in conjunction with Article 228 (3), second subparagraph thereof,

Having regard to the assent of the European Parliament [1],

Whereas the Agreement on the European Economic Area between the European Communities, their Member States and the Republic of Austria, the Republic of Finland, the Republic of Iceland, the Principality of Liechtenstein, the Kingdom of Norway, the Kingdom of Sweden and the Swiss Confederation, signed in Oporto on 2 May 1992 should be approved,

HAVE DECIDED AS FOLLOWS:

Article 1

The Agreement on the European Economic Area between the European Communities, their Member States and the Republic of Austria, the Republic of Finland, the Republic of Iceland, the Principality of Liechtenstein, the Kingdom of Norway, the Kingdom of Sweden and the Swiss Confederation, the Protocols, the Annexes annexed thereto and the Declarations, the Agreed Minutes and exchanges of letters attached to the Final Act are hereby approved on behalf of the European Community and the European Coal and Steel Community.

The texts of the acts referred to in the first paragraph are attached to this Decision.

Article 2

The act of approval provided for in Article 129 of the Agreement shall be deposited by the President of the Council on behalf of the European Community and by the President of the Commission on behalf of the European Coal and Steel Community [2].

Done at Brussels, 13 December 1993.

For the Council	*For the Commission*
The President	*The President*
Ph. MAYSTADT	J. DELORS

[1] OJ No C 305, 23. 11. 1992, p. 66.

[2] See page 606 of this Official Journal.

PROTOCOL 21

on the implementation of competition rules applicable to undertakings

Article 1

The EFTA Surveillance Authority shall, in an agreement between the EFTA States, be entrusted with equivalent powers and similar functions to those of the EC Commission, at the time of the signature of the Agreement, for the application of the competition rules of the Treaty establishing the European Economic Community and the Treaty establishing the European Coal and Steel Community, enabling the EFTA Surveillance Authority to give effect to the principles laid down in Articles 1(2)(e) and 53 to 60 of the Agreement, and in Protocol 25.

The Community shall, where necessary, adopt the provisions giving effect to the principles laid down in Articles 1(2)(e) and 53 to 60 of the Agreement, and in Protocol 25, in order to ensure that the EC Commission has equivalent powers and similar functions under this Agreement to those which it has, at the time of the signature of the Agreement, for the application of the competition rules of the Treaty establishing the European Economic Community and the Treaty establishing the European Coal and Steel Community.

Article 2

If, following the procedures set out in Part VII of the Agreement, new acts for the implementation of Articles 1(2)(e) and 53 to 60 and of Protocol 25, or on amendments of the acts listed in Article 3 of this Protocol are adopted, corresponding amendments shall be made in the agreement setting up the EFTA Surveillance Authority so as to ensure that the EFTA Surveillance Authority will be entrusted simultaneously with equivalent powers and similar functions to those of the EC Commission.

Article 3

1. In addition to the acts listed in Annex XIV, the following acts reflect the powers and functions of the EC Commission for the application of the competition rules of the Treaty establishing the European Economic Community:

Control of concentrations

1. **389 R 4064:** Articles 6 to 25 of Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings (OJ No L 395, 30.12.1989, p. 1), as corrected by OJ No L 257, 21.9.1990, p. 13.

2. **390 R 2367:** Commission Regulation (EEC) No 2367/90 of 25 July 1990 on the notifications, time limits and hearings provided for in Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings (OJ No L 219, 14.8.1990, p. 5).

General procedural rules

3. **362 R 0017:** Council Regulation No 17/62 of 6 February 1962. First Regulation implementing Articles 85 and 86 of the Treaty (OJ No 13, 21.2.1962, p. 204/62), as amended by:

   — **362 R 0059:** Regulation No 59/62 of 3 July 1962 (OJ No 58, 10.7.1962, p. 1655/62),

   — **363 R 0118:** Regulation No 118/63 of 5 November 1963 (OJ No 162, 7.11.1963, p. 2696/63),

   — **371 R 2822:** Regulation (EEC) No 2822/71 of 20 December 1971 (OJ No L 285, 29.12.1971, p. 49),

   — **1 72 B:** Act concerning the conditions of Accession and Adjustments to the Treaties — Accession to the European Communities of the Kingdom of Denmark, Ireland and the United Kingdom of Great Britain and Northern Ireland (OJ No L 73, 27.3.1972, p. 92),

   — **1 79 H:** Act concerning the conditions of Accession and Adjustments to the Treaties — Accession to the European Communities of the Hellenic Republic (OJ No L 291, 19.11.1979, p. 93),

   — **1 85 I:** Act concerning the conditions of Accession and Adjustments to the Treaties — Accession to the European Communities of the Kingdom of Spain and the Portuguese Republic (OJ No L 302, 15.11.1985, p. 165).

4. **362 R 0027:** Commission Regulation No 27/62 of 3 May 1962. First Regulation implementing Council Regulation No 17/62 of 6 February 1962 (Form, content and other details concerning applications and notifications) (OJ No 35, 10.5.1962, p. 1118/62), as amended by:

   — **368 R 1133:** Regulation (EEC) No 1133/68 of 26 July 1968 (OJ No L 189, 1.8.1968, p. 1),

   — **375 R 1699:** Regulation (EEC) No 1699/75 of 2 July 1975 (OJ No L 172, 3.7.1975, p. 11),

   — **1 79 H:** Act concerning the conditions of Accession and Adjustments to the Treaties — Accession to the European Communities of the Hellenic Republic (OJ No L 291, 19.11.1979, p. 94),

   — **385 R 2526:** Regulation (EEC) No 2526/85 of 5 August 1985 (OJ No L 240, 7.9.1985, p. 1),

   — **1 85 I:** Act concerning the conditions of Accession and Adjustments to the Treaties — Accession to the European Communities of the Kingdom of Spain and the Portuguese Republic (OJ No L 302, 15.11.1985, p. 166).

5. **363 R 0099:** Commission Regulation No 99/63 of 25 July 1963 on the hearings provided for in Article 19(1) and (2) of Council Regulation (EEC) No 17/62 (OJ No 127, 20.8.1963, p. 2268/63).

Transport

6. **362 R 0141:** Council Regulation No 141/62 of 26 November 1962 exempting transport from the application of Council Regulation No 17/62 amended by Regulations Nos 165/65/EEC and 1002/67/EEC (OJ No 124, 28.11.1962, p. 2751/62).

7. **368 R 1017:** Article 6 and Articles 10 to 31 of Council Regulation (EEC) No 1017/68 of 19 July 1968 applying rules of competition to transport by rail, road and inland waterway (OJ No L 175, 23.7.1968, p. 1).

8. **369 R 1629:** Commission Regulation (EEC) No 1629/69 of 8 August 1969 on the form, content and other details of complaints pursuant to Article 10, applications pursuant to Article 12 and notifications pursuant to Article 14(1) of Council Regulation (EEC) No 1017/68 of 19 July 1968 (OJ No L 209, 21.8.1969, p. 1).

9. **369 R 1630:** Commission Regulation (EEC) No 1630/69 of 8 August 1969 on the hearings provided for in Article 26(1) and (2) of Council Regulation (EEC) No 1017/68 of 19 July 1968 (OJ No L 209, 21.8.1969, p. 11).

10. **374 R 2988:** Council Regulation (EEC) No 2988/74 of 26 November 1974 concerning limitation periods

in proceedings and the enforcement of sanctions under the rules of the European Economic Community relating to transport and competition (OJ No L 319, 29.11.1974, p. 1).

11. **386 R 4056:** Section II of Council Regulation (EEC) No 4056/86 of 22 December 1986 laying down detailed rules for the application of Articles 85 and 86 of the Treaty to maritime transport (OJ No L 378, 31.12.1986, p. 4).

12. **388 R 4260:** Commission Regulation (EEC) No 4260/88 of 16 December 1988 on the communications, complaints and applications and the hearings provided for in Council Regulation (EEC) No 4056/86 laying down detailed rules for the application of Articles 85 and 86 of the Treaty to maritime transport (OJ No L 376, 31.12.1988, p. 1).

13. **387 R 3975:** Council Regulation (EEC) No 3975/87 of 14 December 1987 laying down the procedure for the application of the rules on competition to undertakings in the air transport sector (OJ No L 374, 31.12.1987, p. 1), as amended by:

    — **391 R 1284:** Council Regulation (EEC) No 1284/91 of 14 May 1991 (OJ No L 122, 17.5.1991, p. 2).

14. **388 R 4261:** Commission Regulation (EEC) No 4261/88 of 16 December 1988 on the form, content and other details of complaints and of applications, and the hearings provided for in Council Regulation (EEC) No 3975/87 laying down the procedure for the application of the rules of competition to undertakings in the air transport sector (OJ No L 376, 31.12.1988, p. 10).

2. In addition to the acts listed in Annex XIV, the following acts reflect the powers and functions of the EC Commission for the application of the competition rules of the Treaty establishing the European Coal and Steel Community (ECSC):

1. Article (ECSC) 65(2), subparagraphs 3 to 5, (3), (4), subparagraph 2, and (5).

2. Article (ECSC) 66(2), subparagraphs 2 to 4, and (4) to (6).

3. **354 D 7026:** High Authority Decision No 26/54 of 6 May 1954 laying down in implementation of Article 66(4) of the Treaty a regulation concerning information to be furnished (*Official Journal of the European Coal and Steel Community* No 9, 11.5.1954, p. 350/54).

4. **378 S 0715:** Commission Decision No 715/78/ECSC of 6 April 1978 concerning limitation periods in proceedings and the enforcement of sanctions under the Treaty establishing the European Coal and Steel Community (OJ No L 94, 8.4.1978, p. 22).

5. **384 S 0379:** Commission Decision No 379/84/ECSC of 15 February 1984 defining the powers of officials and agents of the Commission instructed to carry out the checks provided for in the ECSC Treaty and decisions taken in application thereof (OJ No L 46, 16.2.1984, p. 23).

Article 4

1. Agreements, decisions and concerted practices of the kind described in Article 53(1) which come into existence after the entry into force of the Agreement and in respect of which the parties seek application of Article 53(3) shall be notified to the competent surveillance authority pursuant to Article 56, Protocol 23 and the rules referred to in Articles 1 to 3 of this Protocol. Until they have been notified, no decision in application of Article 53(3) may be taken.

2. Paragraph 1 shall not apply to agreements, decisions and concerted practices where:

(a) the only parties thereto are undertakings from one EC Member State or from one EFTA State and the agreements, decisions or concerted practices do not relate either to imports or to exports between Contracting Parties;

(b) not more than two undertakings are party thereto, and the agreements only:

  (i) restrict the freedom of one party to the contract in determining the prices or conditions of business upon which the goods which he has obtained from the other party to the contract may be resold, or

  (ii) impose restrictions on the exercise of the rights of the assignee or user of industrial property rights - in particular patents, utility models, designs or trademarks - or of the person entitled under a contract to the assignment, or grant, of the right to use a method of manufacture or knowledge relating to the use and to the application of industrial processes;

(c) they have as their sole object:

  (i) the development or uniform application of standards or types, or

  (ii) joint research or development, or

  (iii) specialization in the manufacture of products including agreements necessary for achieving this:

    — where the products which are the subject of specialization do not, in a substantial part of the territory covered by the Agreement, represent more than 15 per cent of the volume of business done in identical products or those considered by consumers to be similar by reason of their characteristics, price and use, and

— where the total annual turnover of the participating undertakings does not exceed ECU 200 million.

These agreements, decisions and concerted practices may be notified to the competent surveillance authority pursuant to Article 56, Protocol 23 and the rules referred to in Articles 1 to 3 of this Protocol.

Article 5

1. Agreements, decisions and concerted practices of the kind described in Article 53(1) which are in existence at the date of entry into force of the Agreement and in respect of which the parties seek application of Article 53(3) shall be notified to the competent surveillance authority pursuant to the provisions in Article 56, Protocol 23 and the rules referred to in Articles 1 to 3 of this Protocol within six months of the date of entry into force of the Agreement.

2. Paragraph 1 shall not apply to agreements, decisions or concerted practices of the kind described in Article 53(1) of the Agreement and falling under Article 4(2) of this Protocol; these may be notified to the competent surveillance authority pursuant to Article 56, Protocol 23 and the rules referred to in Articles 1 to 3 of this Protocol.

Article 6

The competent surveillance authority shall specify in its decisions pursuant to Article 53(3) the date from which the decisions shall take effect. That date may be earlier than the date of notification as regards agreements, decisions of associations of undertakings or concerted practices falling under Articles 4(2) and 5(2) of this Protocol, or those falling under Article 5(1) of this Protocol which have been notified within the time limit specified in Article 5(1).

Article 7

1. Where agreements, decisions or concerted practices of the kind described in Article 53(1) which are in existence at the date of entry into force of the Agreement and notified within the time limits specified in Article 5(1) of this Protocol do not satisfy the requirements of Article 53(3) and the undertakings or associations of undertakings concerned cease to give effect to them or modify them in such a manner that they no longer fall under the prohibition contained in Article 53(1) or that they satisfy the requirements of Article 53(3), the prohibition contained in Article 53(1) shall apply only for a period fixed by the competent surveillance authority. A decision by the competent surveillance authority pursuant to the foregoing sentence shall not apply as against undertakings and associations of undertakings which did not expressly consent to the notification.

2. Paragraph 1 shall apply to agreements, decisions or concerted practices falling under Article 4(2) of this Protocol which are in existence at the date of entry into force of the Agreement if they are notified within six months after that date.

Article 8

Applications and notifications submitted to the EC Commission prior to the date of entry into force of the Agreement shall be deemed to comply with the provisions on application and notification under the Agreement.

The competent surveillance authority pursuant to Article 56 of the Agreement and Article 10 of Protocol 23 may require a duly completed form as prescribed for the implementation of the Agreement to be submitted to it within such time as it shall appoint. In that event, applications and notifications shall be treated as properly made only if the forms are submitted within the prescribed period and in accordance with the provisions of the Agreement.

Article 9

Fines for infringement of Article 53(1) shall not be imposed in respect of any act prior to notification of the agreements, decisions and concerted practices to which Articles 5 and 6 of this Protocol apply and which have been notified within the period specified therein.

Article 10

The Contracting Parties shall ensure that the measures affording the necessary assistance to officials of the EFTA Surveillance Authority and the EC Commission, in order to enable them to make their investigations as foreseen under the Agreement, are taken within six months of the entry into force of the Agreement.

Article 11

As regards agreements, decisions and concerted practices already in existence at the date of entry into force of the Agreement which fall under Article 53(1), the prohibition in Article 53(1) shall not apply where the agreements, decisions or practices are modified within six months from the date of entry into force of the Agreement so as to fulfil the conditions contained in the block exemptions provided for in Annex XIV.

Article 12

As regards agreements, decisions of associations of undertakings and concerted practices already in existence at the date of entry into force of the Agreement which fall under Article 53(1), the prohibition in Article 53(1) shall not apply, from the date of entry into force of the Agreement, where the agreements, decisions or practices are modified within six months from the date of entry into force of the Agreement so as not to fall under the prohibition of Article 53(1) any more.

Article 13

Agreements, decisions of associations of undertakings and concerted practices which benefit from an individual exemption granted under Article 85(3) of the Treaty establishing the European Economic Community before the entry into force of the Agreement shall continue to be exempted as regards the provisions of the Agreement, until their date of expiry as provided for in the decisions granting these exemptions or until the EC Commission otherwise decides, whichever date is the earlier.

PROTOCOL 22

concerning the definition of 'undertaking' and 'turnover' (Article 56)

Article 1

For the purposes of the attribution of individual cases pursuant to Article 56 of the Agreement, an 'undertaking' shall be any entity carrying out activities of a commercial or economic nature.

Article 2

'Turnover' within the meaning of Article 56 of the Agreement shall comprise the amounts derived by the undertakings concerned, in the territory covered by the Agreement, in the preceding financial year from the sale of products and the provision of services falling within the undertaking's ordinary scope of activities after deduction of sales rebates and of value-added tax and other taxes directly related to turnover.

Article 3

In place of turnover, the following shall be used:

(a) for credit institutions and other financial institutions, their total assets multiplied by the ratio between loans and advances to credit institutions and customers in transactions with residents in the territory covered by the Agreement and the total sum of those loans and advances;

(b) for insurance undertakings, the value of gross premiums received from residents in the territory covered by the Agreement, which shall comprise all amounts received and receivable in respect of insurance contracts issued by or on behalf of the insurance undertakings, including also outgoing reinsurance premiums, and after deduction of taxes and parafiscal contributions or levies charged by reference to the amounts of individual premiums or the total value of premiums.

Article 4

1. In derogation from the definition of the turnover relevant for the application of Article 56 of the Agreement, as contained in Article 2 of this Protocol, the relevant turnover shall be constituted:

(a) as regards agreements, decisions of associations of undertakings and concerted practices related to distribution and supply arrangements between non-competing undertakings, of the amounts derived from the sale of goods or the provision of services which are the subject matter of the agreements, decisions or concerted practices, and from the other goods or services which are considered by users to be equivalent in view of their characteristics, price and intended use;

(b) as regards agreements, decisions of associations of undertakings and concerted practices related to arrangements on transfer of technology between non-competing undertakings, of the amounts derived from the sale of goods or the provision of services which result from the technology which is the subject matter of the agreements, decisions or concerted practices, and of the amounts derived from the sale of those goods or the provision of those services which that technology is designed to improve or replace.

2. However, where at the time of the coming into existence of arrangements as described in paragraph 1(a) and (b) turnover as regards the sale of goods or the provision of services is not in evidence, the general provision as contained in Article 2 shall apply.

Article 5

1. Where individual cases concern products falling within the scope of application of Protocol 25, the relevant turnover for the attribution of those cases shall be the turnover achieved in these products.

2. Where individual cases concern products falling within the scope of application of Protocol 25 as well as products or services falling within the scope of application of Articles 53 and 54 of the Agreement, the relevant turnover is determined by taking into account all the products and services as provided for in Article 2.

PROTOCOL 23

concerning the cooperation between the surveillance authorities (Article 58)

GENERAL PRINCIPLES

Article 1

The EFTA Surveillance Authority and the EC Commission shall exchange information and consult each other on general policy issues at the request of either of the surveillance authorities.

The EFTA Surveillance Authority and the EC Commission, in accordance with their internal rules, respecting Article 56 of the Agreement and Protocol 22 and the autonomy of both sides in their decisions, shall cooperate in the handling of individual cases falling under Article 56(1)(b) and (c), (2), second sentence and (3), as provided for in the provisions below.

For the purposes of this Protocol, the term 'territory of a surveillance authority' shall mean for the EC Commission the territory of the EC Member States to which the Treaty establishing the European Economic Community or the Treaty establishing the European Coal and Steel Community, as the case may be, applies, upon the terms laid down in those Treaties, and for the EFTA Surveillance Authority the territories of the EFTA States to which the Agreement applies.

THE INITIAL PHASE OF THE PROCEEDINGS

Article 2

In cases falling under Article 56(1)(b) and (c), (2), second sentence and (3) of the Agreement, the EFTA Surveillance Authority and the EC Commission shall without undue delay forward to each other notifications and complaints to the extent that it is not apparent that these have been addressed to both surveillance authorities. They shall also inform each other when opening *ex officio* procedures.

The surveillance authority which has received information as provided for in the first subparagraph may present its comments thereon within 40 working days of its receipt.

Article 3

The competent surveillance authority shall, in cases falling under Article 56(1)(b) and (c), (2), second sentence and (3) of the Agreement, consult the other surveillance authority when:

— publishing its intention to give a negative clearance,

— publishing its intention to take a decision in application of Article 53(3), or

— addressing to the undertakings or associations of undertakings concerned its statement of objections.

The other surveillance authority may deliver its comments within the time limits set out in the abovementioned publication or statement of objections.

Observations received from the undertakings concerned or third parties shall be transmitted to the other surveillance authority.

Article 4

In cases falling under Article 56(1)(b) and (c), (2), second sentence and (3) of the Agreement, the competent surveillance authority shall transmit to the other surveillance authority the administrative letters by which a file is closed or a complaint rejected.

Article 5

In cases falling under Article 56(1)(b) and (c), (2), second sentence and (3) of the Agreement, the competent surveillance authority shall invite the other surveillance authority to be represented at hearings of the undertakings concerned. The invitation shall also extend to the States falling within the competence of the other surveillance authority.

ADVISORY COMMITTEES

Article 6

In cases falling under Article 56(1)(b) and (c), (2), second sentence and (3) of the Agreement, the competent surveillance authority shall, in due time, inform the other surveillance authority of the date of the meeting of the Advisory Committee and transmit the relevant documentation.

All documents forwarded for that purpose from the other surveillance authority shall be presented to the Advisory Committee of the surveillance authority which is competent to decide on a case in accordance with Article 56 together with the material sent out by that surveillance authority.

Each surveillance authority and the States falling within its competence shall be entitled to be present in the Advisory Committees of the other surveillance authority and to express their views therein; they shall not have, however, the right to vote.

REQUEST FOR DOCUMENTS AND TH ERIGHT TO MAKE OBSERVATIONS

Article 7

In cases falling under Article 56(1)(b) and (c), (2), second sentence and (3) of the Agreement, the surveillance authority which is not competent to decide on a case in accordance with Article 56 may request at all stages of the proceedings copies of the most important documents lodged with the competent surveillance authority for the purpose of establishing the existence of infringements of Articles 53 and 54 or of obtaining a negative clearance or exemption, and may furthermore, before a final decision is taken, make any observations it considers appropriate.

ADMINISTRATIVE ASSISTANCE

Article 8

1. When sending a request for information to an undertaking or association of undertakings located within the territory of the other surveillance authority, the competent surveillance authority, as defined in Article 56 of the Agreement, shall at the same time forward a copy of the request to the other surveillance authority.

2. Where an undertaking or association of undertakings does not supply the information requested within the time limit fixed by the competent surveillance authority, or supplies incomplete information, the competent surveillance authority shall by decision require the information to be supplied. In the case of undertakings or associations of undertakings located within the territory of the other surveillance authority, the competent surveillance authority shall forward a copy of that decision to the other surveillance authority.

3. At the request of the competent surveillance authority, as defined in Article 56 of the Agreement, the other surveillance authority shall, in accordance with its internal rules, undertake investigations within its territory in cases where the competent surveillance authority so requesting considers it to be necessary.

4. The competent surveillance authority is entitled to be represented and take an active part in investigations carried out by the other surveillance authority in respect of paragraph 3.

5. All information obtained during such investigations on request shall be transmitted to the surveillance authority which requested the investigations immediately after their finalization.

6. Where the competent surveillance authority, in cases falling under Article 56(1)(b) and (c), (2), second sentence and (3) of the Agreement, carries out investigations within its territory, it shall inform the other surveillance authority of the fact that such investigations have taken place and, on request, transmit to that authority the relevant results of the investigations.

Article 9

1. Information acquired as a result of the application of this Protocol shall be used only for the purpose of procedures under Articles 53 and 54 of the Agreement.

2. The EC Commission, the EFTA Surveillance Authority, the competent authorities of the EC Member States and the EFTA States, and their officials and other servants shall not disclose information acquired by them as a result of the application of this Protocol and of the kind covered by the obligation of professional secrecy.

3. Rules on professional secrecy and restricted use of information provided for in the Agreement or in the legislation of the Contracting Parties shall not prevent exchange of information as set out in this Protocol.

Article 10

1. Undertakings shall, in cases of notifications of agreements, address the notification to the competent surveillance authority in accordance with Article 56 of the Agreement. Complaints may be addressed to either surveillance authority.

2. Notifications or complaints addressed to the surveillance authority which, pursuant to Article 56, is not competent to decide on a given case shall be transferred without delay to the competent surveillance authority.

3. If, in the preparation or initiation of *ex officio* proceedings, it becomes apparent that the other surveillance authority is competent to decide on a case in accordance with Article 56 of the Agreement, this case shall be transferred to the competent surveillance authority.

4. Once a case is transmitted to the other surveillance authority as provided for in paragraphs 2 and 3, a retransmission of the case may not take place. A transmission of a case may not take place after the publishing of the intention to give a negative clearance, the publishing of the intention to take a decision in application of Article 53(3) of the Agreement, the addressing to undertakings or associations of undertakings concerned of the statement of objections or the sending of a letter informing the applicant that there are insufficient grounds for pursuing the complaint.

Article 11

The date of submission of an application or notification shall be the date on which it is received by the EC Commission or the EFTA Surveillance Authority, regardless of which of these is competent to decide on the case under Article 56 of the Agreement. Where, however, the application or notification is sent by registered post, it shall be deemed to have been received on the date shown on the postmark of the place of posting.

LANGUAGES

Article 12

Undertakings shall be entitled to address and be addressed by the EFTA Surveillance Authority and the EC Commission in an official language of an EFTA State or the European Community which they choose as regards notifications, applications and complaints. This shall also cover all instances of a proceeding, whether it be opened on notification, application or complaint or *ex officio* by the competent surveillance authority.

PROTOCOL 24

on cooperation in the field of control of concentrations

GENERAL PRINCIPLES

Article 1

1. The EFTA Surveillance Authority and the EC Commission shall exchange information and consult each other on general policy issues at the request of either of the surveillance authorities.

2. In cases falling under Article 57(2)(a), the EC Commission and the EFTA Surveillance Authority shall cooperate in the handling of concentrations as provided for in the provisions set out below.

3. For the purposes of this Protocol, the term 'territory of a surveillance authority' shall mean for the EC Commission the territory of the EC Member States to which the Treaty establishing the European Economic Community or the Treaty establishing the European Coal and Steel Community, as the case may be, applies, upon the terms laid down in those Treaties, and for the

EFTA Surveillance Authority the territories of the EFTA States to which the Agreement applies.

Article 2

1. Cooperation shall take place, in accordance with the provisions set out in this Protocol, where:

(a) the combined turnover of the undertakings concerned in the territory of the EFTA States equals 25 per cent or more of their total turnover within the territory covered by the Agreement, or

(b) each of at least two of the undertakings concerned has a turnover exceeding ECU 250 million in the territory of the EFTA States, or

(c) the concentration is liable to create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the territories of the EFTA States or a substantial part thereof.

2. Cooperation shall also take place where:

(a) the concentration threatens to create or strengthen a dominant position as a result of which effective competition would be significantly impeded on a market within an EFTA State which presents all the characteristics of a distinct market, be it a substantial part of the territory covered by this Agreement or not, or

(b) an EFTA State wishes to adopt measures to protect legitimate interests as set out in Article 7.

INITIAL PHASE OF THE PROCEEDINGS

Article 3

1. The EC Commission shall transmit to the EFTA Surveillance Authority copies of notifications of the cases referred to in Article 2(1) and (2)(a) within three working days and, as soon as possible, copies of the most important documents lodged with or issued by the EC Commission.

2. The EC Commission shall carry out the procedures set out for the implementation of Article 57 of the Agreement in close and constant liaison with the EFTA Surveillance Authority. The EFTA Surveillance Authority and EFTA States may express their views upon those procedures. For the purposes of Article 6 of this Protocol, the EC Commission shall obtain information from the competent authority of the EFTA State concerned and give it the opportunity to make known its views at every stage of the procedures up to the adoption of a decision pursuant to that Article. To that end, the EC Commission shall give it access to the file.

HEARINGS

Article 4

In cases referred to in Article 2(1) and (2)(a), the EC Commission shall invite the EFTA Surveillance Authority to be represented at the hearings of the undertakings concerned. The EFTA States may likewise be represented at those hearings.

THE EC ADVISORY COMMITTEE ON CONCENTRATIONS

Article 5

1. In cases referred to in Article 2(1) and (2)(a), the EC Commission shall in due time inform the EFTA Surveillance Authority of the date of the meeting of the EC Advisory Committee on Concentrations and transmit the relevant documentation.

2. All documents forwarded for that purpose from the EFTA Surveillance Authority, including documents emanating from EFTA States, shall be presented to the EC Advisory Committee on Concentrations together with the other relevant documentation sent out by the EC Commission.

3. The EFTA Surveillance Authority and the EFTA States shall be entitled to be present in the EC Advisory Committee on Concentrations and to express their views therein; they shall not have, however, the right to vote.

RIGHTS OF INDIVIDUAL STATES

Article 6

1. The EC Commission may, by means of a decision notified without delay to the undertakings concerned, to the competent authorities of the EC Member States and to the EFTA Surveillance Authority, refer a notified concentration to an EFTA State where a concentration threatens to create or strengthen a dominant position as a result of which effective competition would be significantly impeded on a market within that State, which presents all the characteristics of a distinct market, be it a substantial part of the territory covered by the Agreement or not.

2. In cases referred to in paragraph 1, any EFTA State may appeal to the European Court of Justice, on the same grounds and conditions as an EC Member State under Article 173 of the Treaty establishing the European Economic Community, and in particular request the application of interim measures, for the purpose of applying its national competition law.

Article 7

1. Notwithstanding the sole competence of the EC Commission to deal with concentrations of a Community dimension as set out in Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings (OJ No L 395, 30.12.1989, p. 1, as corrected by OJ No L 257, 21.9.1990, p. 13), EFTA States may take appropriate measures to protect legitimate interests other than those taken into consideration according to the above Regulation and compatible with the general principles and other provisions as provided for, directly or indirectly, under the Agreement.

2. Public security, plurality of media and prudential rules shall be regarded as legitimate interests within the meaning of paragraph 1.

3. Any other public interest must be communicated to the EC Commission and shall be recognized by the EC Commission after an assessment of its compatibility with the general principles and other provisions as provided for, directly or indirectly, under the Agreement before the measures referred to above may be taken. The EC Commission shall inform the EFTA Surveillance Authority and the EFTA State concerned of its decision within one month of that communication.

ADMINISTRATIVE ASSISTANCE

Article 8

1. In carrying out the duties assigned to it for the implementation of Article 57, the EC Commission may obtain all necessary information from the EFTA Surveillance Authority and EFTA States.

2. When sending a request for information to a person, an undertaking or an association of undertakings located within the territory of the EFTA Surveillance Authority, the EC Commission shall at the same time forward a copy of the request to the EFTA Surveillance Authority.

3. Where such persons, undertakings or associations of undertakings do not provide the information requested within the period fixed by the EC Commission, or provide incomplete information, the EC Commission shall by decision require the information to be provided and forward a copy of that decision to the EFTA Surveillance Authority.

4. At the request of the EC Commission, the EFTA Surveillance Authority shall undertake investigations within its territory.

5. The EC Commission is entitled to be represented and take an active part in investigations carried out pursuant to paragraph 4.

6. All information obtained during such investigations on request shall be transmitted to the EC Commission immediately after their finalization.

7. Where the EC Commission carries out investigations within the territory of the Community, it shall, as regards cases falling under Article 2(1) and (2)(a), inform the EFTA Surveillance Authority of the fact that such investigations have taken place and on request transmit in an appropriate way the relevant results of the investigations.

PROFESSIONAL SECRECY

Article 9

1. Information acquired as a result of the application of this Protocol shall be used only for the purpose of procedures under Article 57 of the Agreement.

2. The EC Commission, the EFTA Surveillance Authority, the competent authorities of the EC Member States and of the EFTA States, and their officials and other servants shall not disclose information acquired by them as a result of the application of this Protocol and of the kind covered by the obligation of professional secrecy.

3. Rules on professional secrecy and restricted use of information provided for in the Agreement or the legislation of the Contracting Parties shall not prevent the exchange and use of information as set out in this Protocol.

NOTIFICATIONS

Article 10

1. Undertakings shall address their notifications to the competent surveillance authority in accordance with Article 57(2) of the Agreement.

2. Notifications or complaints addressed to the authority which, pursuant to Article 57, is not competent to take decisions on a given case shall be transferred without delay to the competent surveillance authority.

Article 11

The date of submission of a notification shall be the date on which it is received by the competent surveillance authority.

The date of submission of a notification shall be the date on which it is received by the EC Commission or the EFTA Surveillance Authority, if the case is notified in accordance with the implementing rules under Article 57 of the Agreement, but falls under Article 53.

LANGUAGES

Article 12

1. Undertakings shall be entitled to address and be addressed by the EFTA Surveillance Authority and the EC Commission in an official language of an EFTA State or the Community which they choose as regards notifications. This shall also cover all instances of a proceeding.

2. If undertakings choose to address a surveillance authority in a language which is not one of the official languages of the States falling within the competence of that authority, or a working language of that authority, they shall simultaneously supplement all documentation with a translation into an official language of that authority.

3. As far as undertakings are concerned which are not parties to the notification, they shall likewise be entitled to be addressed by the EFTA Surveillance Authority and the EC Commission in an appropriate official language of an EFTA State or of the Community or in a working language of one of those authorities. If they choose to address a surveillance authority in a language which is not one of the official languages of the States falling within the competence of that authority, or a working language of that authority, paragraph 2 shall apply.

4. The language which is chosen for the translation shall determine the language in which the undertakings may be addressed by the competent authority.

TIME LIMITS AND OTHER PROCEDURAL QUESTIONS

Article 13

As regards time limits and other procedural provisions, the rules implementing Article 57 shall apply also for the purpose of the cooperation between the EC Commission and the EFTA Surveillance Authority and EFTA States, unless otherwise provided for in this Protocol.

TRANSITION RULE

Article 14

Article 57 shall not apply to any concentration which was the subject of an agreement or announcement or where control was acquired before the date of entry into force of the Agreement. It shall not in any circumstances apply to a concentration in respect of which proceedings were initiated before that date by a national authority with responsibility for competition.

ANNEX XIV

COMPETITION

List provided for in Article 60

INTRODUCTION

When the acts referred to in this Annex contain notions or refer to procedures which are specific to the Community legal order, such as

— preambles;

— the addressees of the Community acts;

— references to territories or languages of the EC;

— references to rights and obligations of EC Member States, their public entities, undertakings or individuals in relation to each other; and

— references to information and notification procedures;

Protocol 1 on horizontal adaptations shall apply, unless otherwise provided for in this Annex.

SECTORAL ADAPTATIONS

Unless otherwise provided for, the provisions of this Annex shall, for the purposes of the present Agreement, be read with the following adaptations:

I. the term 'Commission' shall read 'competent surveillance authority';

II. the term 'common market' shall read 'the territory covered by the EEA Agreement';

III. the term 'trade between Member States' shall read 'trade between Contracting Parties';

IV. the term 'the Commission and the authorities of the Member States' shall read 'the EC Commission, the EFTA Surveillance Authority, the authorities of the EC Member States and of the EFTA States';

V. References to Articles of the Treaty establishing the European Economic Community (EEC) or the Treaty establishing the European Coal and Steel Community (ECSC) shall be read as references to the EEA Agreement (EEA) as follows:

Article 85 (EEC) - Article 53 (EEA),

Article 86 (EEC) - Article 54 (EEA),

Article 90 (EEC) - Article 59 (EEA),

Article 66 (ECSC) - Article 2 of Protocol 25 to the EEA Agreement,

Article 80 (ECSC) - Article 3 of Protocol 25 to the EEA Agreement.

VI. the term 'this Regulation' shall read 'this Act';

VII. the term 'the competition rules of the Treaty' shall read 'the competition rules of the EEA Agreement';

VIII. the term 'High Authority' shall read 'competent surveillance authority'.

Without prejudice to the rules on control of concentrations, the term 'competent surveillance authority' as referred to in the rules below shall read 'the surveillance authority which is competent to decide on a case in accordance with Article 56 of the EEA Agreement'.

ACTS REFERRED TO

A. Merger control

1. **389 R 4064:** Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings (OJ No L 395, 30.12.1989, p. 1), as corrected by OJ No L 257, 21.9.1990, p. 13.

The provisions of Articles 1 to 5 of the Regulation shall, for the purposes of the Agreement, be read with the following adaptations:

(a) in Article 1(1), the phrase ', or the corresponding provision envisaged in Protocol 21 to the EEA Agreement,' shall be inserted after the words 'Without prejudice to Article 22';

furthermore, the term 'Community dimension' shall be replaced by 'Community or EFTA dimension';

(b) in Article 1(2), the term 'Community dimension' shall be replaced by 'Community or EFTA dimension respectively';

furthermore, the term 'Community-wide turnover' shall be replaced by 'Community-wide or EFTA-wide turnover';

in the last subparagraph, the term 'Member State' shall be replaced by 'State';

(c) Article 1(3) shall not apply;

(d) in Article 2(1), first subparagraph, the term 'common market' shall be replaced by 'functioning of the EEA Agreement';

(e) in Article 2(2), at the end, the term 'common market' shall be replaced by 'functioning of the EEA Agreement';

(f) in Article 2(3), at the end, the term 'common market' shall be replaced by 'functioning of the EEA Agreement';

(g) in Article 3(5)(b), the term 'Member State' shall be replaced by 'EC Member State or an EFTA State';

(h) in Article 4(1), the term 'Community dimension' shall be replaced by 'Community or EFTA dimension';

furthermore, in the first sentence, the phrase 'in accordance with Article 57 of the EEA Agreement' shall be inserted after the words '... shall be notified to the Commission';

(i) in Article 5(1), the last subparagraph shall be replaced by the following:

'Turnover, in the Community or in an EC Member State, shall comprise products sold and services provided to undertakings or consumers, in the Community or in that EC Member State as the case may be. The same shall apply as regards turnover in the territory of the EFTA States as a whole or in an EFTA State.';

(j) in Article 5(3)(a), second subparagraph, the term 'Community-wide turnover' shall be replaced by the words 'Community-wide or EFTA-wide turnover';

furthermore, the term 'Community residents' shall be replaced by 'Community or EFTA residents, respectively';

(k) in Article 5(3)(a), third subparagraph, the term 'Member State' shall be replaced by 'EC Member State or EFTA State';

(l) in Article 5(3)(b), the last phrase '..., gross premiums received from Community residents and from residents of one Member State respectively shall be taken into account.' shall be replaced by the following:

'..., gross premiums received from Community residents and from residents of one EC Member State respectively shall be taken into account. The same shall apply as regards gross premiums received from residents in the territory of the EFTA States as a whole and from residents in one EFTA State, respectively.'

ACTS OF WHICH THE EC COMMISSION AND THE EFTA SURVEILLANCE AUTHORITY SHALL TAKE DUE ACCOUNT

In the application of Articles 53 to 60 of the Agreement and the provisions referred to in this Annex, the EC Commission and the EFTA Surveillance Authority shall take due account of the principles and rules contained in the following acts:

Control of concentrations

16. **C/203/90/p. 5:** Commission Notice regarding restrictions ancillary to concentrations (OJ No C 203, 14.8.1990, p. 5).

17. **C/203/90/p. 10:** Commission Notice regarding the concentrative and cooperative operations under Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings (OJ No C 203, 14.8.1990, p. 10).

COMMISSION REGULATION (EEC) No 2367/90

of 25 July 1990

on the notifications, time limits and hearings provided for in Council Regulation (EEC) No 4064/89 on the control of concentrations between undertakings

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings [1], and in particular Article 23 thereof,

Having regard to Council Regulation No 17 of 6 February 1962, First Regulation implementing Articles 85 and 86 of the Treaty [2], as last amended by the Act of Accession of Spain and Portugal, and in particular Article 24 thereof,

Having regard to Council Regulation (EEC) No 1017/68 of 19 July 1968 applying rules of competition to transport by rail, road and inland waterway [3], as last amended by the Act of Accession of Spain and Portugal, and in particular Article 29 thereof,

Having regard to Council Regulation (EEC) No 4056/86 of 22 December 1986 laying down detailed rules for the application of Articles 85 and 86 of the Treaty to maritime transport [4], and in particular Article 26 thereof,

Having regard to Council Regulation (EEC) No 3975/87 of 14 December 1987 laying down detailed rules for the application of the competition rules to undertakings in air transport [5], and in particular Article 19 thereof,

Having consulted the Advisory Committee on Concentrations, as well as the Advisory Committees on Restrictive Practices and Monopolies in the Transport Industry, in Maritime Transport and in Air Transport,

1. Whereas Article 23 of Regulation (EEC) No 4064/89 empowers the Commission to adopt implementing provisions concerning the form, content and other details of notifications pursuant to Article 4, time limits pursuant to Article 10, and hearings pursuant to Article 18;

2. Whereas Regulation (EEC) No 4064/89 is based on the principle of compulsory notification of concentrations before they are put into effect; hereas, on the one hand, a notification has important legal consequences which are favourable to the parties, while, on the other hand, failure to comply with the obligation to notify renders the parties liable to a fine and may also entail civil law disadvantages for them; whereas it is therefore necessary in the interests of legal certainty to define precisely the subject matter and content of the information to be provided in the notification;

3. Whereas it is for the parties concerned to make full and honest disclosure to the Commission of the facts and circumstances which are relevant for taking a decision on the notified concentration;

4. Whereas in order to simplify and expedite examination of the notification it is desirable to prescribe that a form be used;

5. Whereas since notification sets in motion legal time limits for initiating proceedings and for decisions, the conditions governing such time limits and the time when they become effective must also be determined;

6. Whereas rules must be laid down in the interests of legal certainty for calculating the time limits provided for in Regulation (EEC) No 4064/89; whereas in particular the beginning and end of the period and the circumstances suspending the running of the period must be determined; whereas the provisions should be based on the principles of Regulation (EEC, Euratom) No 1182/71 of 3 June 1971 determining the rules applicable to periods, dates and time limits [6], subject to certain adaptations made necessary by the exceptionally short legal time limits referred to above;

7. Whereas the provisions relating to the Commission's procedure must be framed in such way as to safeguard fully the right to be heard and the rights of defence;

8. Whereas the Commission will give the parties concerned, if they so request, an opportunity before notification to discuss the intended concentration informally and in strict confidence; whereas in addition it will, after notification, maintain close contact with the parties concerned to the extent necessary to discuss with them any practical or legal problems which it discovers on a first examination of the case and if possible to remove such problems by mutual agreement;

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(1) OJ No L 395, 30. 12. 1989, p. 1.
(2) OJ No 13, 21. 2. 1962, p. 204/62.
(3) OJ No L 175, 23. 7. 1968, p. 1.
(4) OJ No L 378, 31. 12. 1986, p. 4.
(5) OJ No L 374, 31. 12. 1987, p. 1.
(6) OJ No L 124, 8. 6. 1971, p. 1.

9. Whereas in accordance with the principle of the right to be heard, the parties concerned must be given the opportunity to submit their comments on all the objections which the Commission proposes to take into account in its decisions;

10. Whereas third parties having sufficient interest must also be given the opportunity of expressing their views where they make a written application;

11. Whereas the various persons entitled to submit comments should do so in writing, both in their own interest and in the interest of good administration, without prejudice to their right to request an oral hearing where appropriate to supplement the written procedure; whereas in urgent cases, however, the Commission must be able to proceed immediately to oral hearings of the parties concerned or third parties; hereas in such cases the persons to be heard must have the right to confirm their oral statements in writing;

12. Whereas it is necessary to define the rights of persons who are to be heard, to what extent they should be granted access to the Commission's file and on what conditions they may be represented or assisted;

13. Whereas it is also necessary to define the rules for fixing and calculating the time limits for reply fixed by the Commission;

14. Whereas the Advisory Committee on Concentrations shall deliver its opinion on the basis of a preliminary draft decision; whereas it must therefore be consulted on a case after the inquiry in to that case has been completed; whereas such consultation does not, however, prevent the Commission from re-opening an inquiry if need be,

HAS ADOPTED THIS REGULATION:

SECTION I

NOTIFICATIONS

Article 1

Persons entitled to submit notifications

1. Notifications shall be submitted by the persons or undertakings referred to in Article 4 (2) of Regulation (EEC) No 4064/89.

2. Where notifications are signed by representatives of persons or of undertakings, such representatives shall produce written proof that they are authorized to act.

3. Joint notifications should be submitted by a joint representative who is authorized to transmit and to receive documents on behalf of all notifying parties.

Article 2

Submission of notifications

1. Notifications shall be submitted in the manner prescribed by form CO as shown in Annex I. Joint notifications shall be submitted on a single form.

2. Twenty copies of each notification and fifteen copies of the supporting documents shall be submitted to the Commission at the address indicated in form CO.

3. The supporting documents shall be either originals or copies of the originals; in the latter case the notifying parties shall confirm that they are true and complete.

4. Notifications shall be in one of the official languages of the Community. This language shall also be the language of the proceeding for the notifying parties. Supporting documents shall be submitted in their original language. Where the original language is not one of the official languages, a translation into the language of the proceeding shall be attached.

Article 3

Information to be provided

1. Notifications shall contain the information requested by form CO. The information must be correct and complete.

2. Material changes in the facts specified in the notification which the notifying parties know or ought to have known must be communicated to the Commission voluntarily and without delay.

3. Incorrect or misleading information shall be deemed to be incomplete information.

Article 4

Effective date of notifications

1. Subject to paragraph 2 notifications shall become effective on the date on which they are received by the Commission.

2. Subject to paragraph 3, where the information contained in the notification is incomplete in a material respect, the Commission shall without delay inform the notifying parties or the joint representative in writing and shall fix an appropriate time limit for the completion of the informaion; in such cases, the notification shall become effective on the date on which the complete information is received by the Commission.

3. The Commission may dispense with the obligation to provide any particular information requested by form CO where the Commission considers that such informatin is not necessary for the examination of the case.

4. The Commission shall without delay acknowledge in writing to the notifying parties or the joint representative receipt of the notification and of any reply to a letter sent by the Commission pursuant to paragraph 2 above.

Article 5

Conversion of notifications

1. Where the Commission finds that the operation notified does not constitute a concentration within the meaning of Article 3 of Regulation (EEC) No 4064/89 it shall inform the notifying parties or the joint representative in writing. In such a case, the Commission may, if requested by the notifying parties, as appropriate and subject to paragraph 2 below, treat the notification as an application within the meaning of Article 2 or a notification within the meaning of Article 4 of Regulation No 17, as an application within the meaning of Article 12 or a notification within the meaning of Article 14 of Regulation (EEC) No 1017/68, as an application within the meaning of Article 12 of Regulation (EEC) No 4056/86 or as an application witin the meaning of Article 3 (2) or of Article 5 of Regulation (EEC) No 3975/87.

2. In cases referred to in paragraph 1, second sentence, the Commission may require that the information given in the notification be supplemented within an appropriate time limit fixed by it in so far as this is necessary for assessing the operation on the basis of the abovementioned Regulations. The application or notification shall be deemed to fulfil the requirements of such Regulations from the date of the original notification where the additional information is received by the Commission within the time limit fixed.

SECTION II

TIME LIMITS FOR INITIATING PROCEEDINGS AND FOR DECISIONS

Article 6

Beginning of the time limit

1. The periods referred to in Article 10 (1) of Regulation (EEC) No 4064/89 shall start at the beginning of the day following the effective date of the notification, within the meaning of Article 4 (1) and (2) of this Regulation.

2. The period referred to in Article 10 (3) of Regulation (EEC) No 4064/89 shall start at the beginning of the day following the day on which proceedings were initiated.

3. Where the first day of a period is not a working day within the meaning of Article 19, the period shall start at the beginning of the following working day.

Article 7

End of the time limit

1. The period referred to in the first subparagraph of Article 10 (1) of Regulation (EEC) No 4064/89 shall end with the expiry of the day which in the month following that in which the period began falls on the same date as the day from which the period runs. Where such a day does not occur in that month, the period shall end with the expiry of the last day of that month.

2. The period referred to in the second sub-paragraph of Article 10 (1) of Regulation (EEC) No 4064/89 shall end with the expiry of the day which in the sixth week following that in which the period began is the same day of the week asthe day from which the period runs.

3. The period referred to in Article 10 (3) of Regulation (EEC) No 4064/89 shall end with the expiry of the day which in the fourth month following that in which the period began falls on the same date as the day from which the period runs. Where such a day does not occur in that month, the period shall end with the expiry of the last day of that month.

4. Where the last day of the period is not a working day within the meaning of Article 19, the period shall end with the expiry of the following working day.

5. Paragraphs 2 to 4 above shall be subject to the provisions of Article 8.

Article 8

Addition of holidays

Where public holidays or other holidays of the Commission as defined in Article 19 fall within the periods referred to in Article 10 (1) and in Article 10 (3) of Regulation (EEC) No 4064/89, these periods shall be extended by a corresponding number of days.

Article 9

Suspension of the time limit

1. The period referred to in Article 10 (3) of Regulation (EEC) No 4064/89 shall be suspended where the Commission, pursuant to Articles 11 (5) or 13 (3) of the same Regulation, has to take a decision because :

(a) Information which the Commission has requested pursuant to Article 11 (2) of Regulation (EEC) No 4064/89 from an undertaking involved in a concentration is not provided or not provided in full within the time limit fixed by the Commission ;

(b) an undertaking involved in the concentration has refused to submit to an investigation deemed necessary by the Commission on the basis of Article 13 (1) of Regulation (EEC) No 4064/89 or to cooperate in the carrying out of such an investigation in accordance with the abovementioned provision ;

(c) the notifying parties have failed to inform the Commission of material changes in the facts specified in the notification.

2. The period referred to in Article 10 (3) of Regulation (EEC) No 4064/89 shall be suspended:

(a) in the cases referred to in subparagraph 1 (a) above, for the period between the end of the time limit fixed in the request for information and the receipt of the complete and correct information required by decision;

(b) in the cases referred to in subparagraph 1 (b) above, for the period between the unsuccessful attempt to carry out the investigation and the completion of the investigation ordered by decision;

(c) in the cases referred to in subparagraph 1 (c) above, for the period between the occurrence of the change in the facts referred to therein and the receipt of the complete and correct information requested by decision or the completion of the investigation ordered by decision.

3. The suspension of the time limit shall begin on the day following that on which the event causing the suspension occurred. It shall end with the expiry of the day on which the reason for suspension is removed. Where such day is not a working day within the meaning of Article 19, the suspension of the time limit shall end with the expiry of the following working day.

Article 10

Compliance with the time limit

The time limits referred to in Article 10 (1) and (3) of Regulation (EEC) No 4064/89 shall be met where the Commission has taken the relevant decision before the end of the period. Notification of the decision to the undertakings concerned must follow without delay.

SECTION III

HEARING OF THE PARTIES AND OF THIRD PARTIES

Article 11

Decisions on the suspension of concentrations

1. Where the Commission intends to take a decision under Article 7 (2) of Regulation (EEC) No 4064/89 or a decision under Article 7 (4) of that Regulation which adversely affects the parties, it shall, pursuant to Article 18 (1) of that Regulation, inform the parties concerned in writing of its objections and shall fix a time limit within which they may make known their views.

2. Where the Commission pursuant to Article 18 (2) of Regulation (EEC) N° 4064/89 has taken a decision referred to in paragraph 1 provisionally without having given the parties concerned the opportunity to make known their views, it shall without delay and in any event before the expiry of the suspension send them the text of the provisional decision and shall fix a time limit within which they may make known their views.

Once the parties concerned have made known their views, the Commission shall take a final decision annulling, amending or confirming the provisional decision. Where the parties concerned have not made known their view within the time limit fixed, the Commission's provisional decision shall become final with the expiry of that period.

3. The parties concerned shall make known their views in writing or orally within the time limit fixed. They may confirm their oral statements in wrting.

Article 12

Decisions on the substance of the case

1. Where the Commission intends to take a decision pursuant to Article 8 (2), second subparagraph, Article 8 (3) (4) and (5), Article 14 or Article 15 of Regulation (EEC) No 4064/89, it shall, before consulting the Advisory Committee on Concentrations, hold a hearing of the parties concerned pursuant to Article 18 of that Regulation.

2. The Commission shall inform the parties concerned in writing of its objections. The communication shall be addressed to the notifying parties or to the joint representative. The Commission shall, when giving notice of objections, fix a time limit within which the parties concerned may inform the Commission of their views.

3. Having informed the parties of its objections, the Commission shall upon request give the parties concerned access to the file for the purposes of preparing their observations. Documents shall not be accessible in so far as they contain business secrets of other parties concerned or of third parties, or other confidential information including sensitive commercial information the disclosure of which would have a significant adverse effect on the supplier of such information or where they are internal documents of the authorities.

4. The parties concerned shall, within the time limit fixed, make known in writing their views on the Commission's objections. The may in their written comments set out all matters relevant to the case and may attach any relevant documents in proof of the facts set out. They may also propose that the Commission hear persons who may corroborate those facts.

Article 13

Oral hearings

1. The Commission shall afford parties concerned who have so requested in their written comments the opportunity to put forward their arguments orally, if those persons show a sufficient interest or if the Commission proposes to impose a fine or periodic penalty payment on them. It may also in other cases afford the parties concerned the opportunity of expressing their views orally.

2. The Commission shall summon the persons to be heard to attend on such date as it shall appoint.

3. It shall forthwith transmit a copy of the summons to the competent authorities of the Member States, who may appoint an official to take part in the hearing.

Article 14

Hearings

1. Hearings shall be conducted by persons appointed by the Commission for that purpose.

2. Persons summoned to attend shall either appear in person or be represented by legal representatives or representatives authorized by their constitution. Undertakings and associations of undertakings may be represented by a duly authorized agent appointed from among their permanent staff.

3. Persons heard by the Commission may be assisted by lawyers or university teachers who are entitled to plead before the Court of Justice of the European Communities in accordance with Article 17 of the Protocol on the Statute (EEC) of the Court of Justice, or by other qualified persons.

4. Hearings shall not be public. Persons shall be heard separately or in the presence of other persons summoned to attend. In the latter case, regard shall be had to the legitimate interest of the undertakings in the protection of their business secrets.

5. The statements made by each person heard shall be recorded.

Article 15

Hearing of third parties

1. If natural or legal persons showing a sufficient interest, and especially members of the administrative or management organs of the undertakings concerned or recognized workers' representatives of those undertakings, apply in writing to be heard pursuant to the second sentence of Article 18 (4) of Regulation (EEC) No 4064/89, the Commission shall inform them in writing of the nature and subject matter of the procedure and shall fix a time limit within which they may make known their views.

2. The third parties referred to in paragraph 1 above shall make known their views in writing or orally within the time limit fixed. They may confirm their oral statements in writing.

3. The Commission may likewise afford to any other third parties the opportunity of expressing their views.

SECTION IV

MISCELLANEOUS PROVISIONS

Article 16

Transmission of documents

1. Transmission of documents and summonses from the Commission to the addressees may be effected in any of the following ways:

(a) delivery by hand against receipt;

(b) registered letter with acknowledgement of receipt;

(c) telefax with a request for acknowledgement of receipt;

(d) telex.

2. Subject to Article 18 (1), paragraph 1 above also applies to the transmission of documents from the parties concerned or from third parties to the Commission.

3. Where a document is sent by telex or by telefax, it shall be presumed that it has been received by the addressee on the day on which it was sent.

Article 17

Setting of time limits

1. In fixing the time limits provided for in Articles 4 (2), 5 (2), 11 (1) and (2), 12 (2) and 15 (1), the Commission shall have regard to the time required for preparation of statements and to the urgency of the case. It shall also take account of public holidays in the country of receipt of the Commission's communication.

2. The day on which the addressee received a communication shall not be taken into account for the purpose of fixing time limits

Article 18

Receipt of documents by the Commission

1. Subject to Article 4 (1), notifications must be delivered to the Commission at the address indicated in form CO or have been dispatched by registered letter before expiry of the period referred to in Article 4 (1) of Regulation (EEC) No 4064/89. Additional information requested to complete notifications pursuant to Article 4 (2) or to supplement notifications pursuant to Article 5 (2) of this Regulation must reach the Commission at the aforesaid or have been dispatched by registered letter before the expiry of the time limit fixed in each case. Written comments on Commission communications pursuant to Articles 11 (1) and (2), 12 (2) and 15 (1) must be delivered to the Commission at the aforesaid address before the time limit fixed in each case.

2. Where the last day of a period referred to in paragraph 1 is a day by which documents must be received and that day is not a working day within the meaning of Article 19, the period shall end with the expiry of the following working day.

3. Where the last day of a period referred to in paragraph 1 is a day by which documents must be dispatched and that day is a Saturday, Sunday or public holiday in the country of dispatch, the period shall end with the expiry of the following working day in that country.

Article 19

Definition of Commission working days

The term 'working days' in Articles 6 (3), 7 (4), 9 (3) and 18 (2) means all days other than Saturdays, Sundays, public holidays set out in Annex II and other holidays as determined by the Commission and published in the *Official Journal of the European Communities* before the beginning of each year.

Article 20

Entry into force

This Regulation shall enter into force on 21 September 1990.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 25 July 1990.

For the Commission

Leon BRITTAN

Vice-President

GUIDANCE NOTE I (*)

CALCULATION OF TURNOVER FOR CREDIT AND OTHER FINANCIAL INSTITUTIONS

(Article 5 (3) (a))

For the calculation of turnover for credit institutions and other financial institutions, we give the following example (proposed merger between bank A and bank B)

I. Consolidated balance sheets

(in million ecu)

Assets	Bank A		Bank B	
Loans and advances to credit institutions	20 000		1 000	
— to credit institutions within the Community:		(10 000)		(500)
— to credit institutions within one (and the same) Member State X:		(5 000)		(500)
Loans and advances to customers	60 000		4 000	
— to Community residents:		(30 000)		(2 000)
— to residents of one (and the same) Member State X:		(15 000)		(500)
Other assets:	20 000		1 000	
Total assets:	100 000		6 000	

II. Calculation of turnover

In place of turnover, the following figures shall be used:

	Bank A	*Bank B*
1. *Aggregate worldwide turnover*		
is replaced by one-tenth of total assets:	10 000	600
the total sum of which is more than ECU 5 000 million.		

2. *Community-wide turnover*

is replaced by, for each bank, one-tenth of total assets multiplied by the ratio between loans and advances to credit institutions and customers within the Community; to the total sum of loans and advances to credit institutions and customers.

	Bank A	*Bank B*
This is calculated as follows:		
one-tenth of total assets:	10 000	600
which is multiplied for each bank by the ratio between:		
loans and advances to credit institutions and customers	10 000	500
within the Community	30 000	2 000
	40 000	2 500
and		
the total sum of loans and advances to credit institutions	20 000	1 000
and customers	60 000	4 000
	80 000	5 000

For

Bank A: 10 000 multiplied by (40 000 : 80 000) = 5 000

Bank B: 600 multiplied by (2 500 : 5 000) = 300

which exceeds ECU 250 million for each of the banks.

(*) In the following guidance notes, the terms 'institution' or 'undertaking' are used subject to the exact delimitation in each case.

3. *Total turnover within one (and the same) Member State X*

	Bank A	*Bank B*
is replaced by one-tenth of total assets:	10 000	600

which is multiplied for each bank by the ratio between loans and advances to credit institutions and customers within one and the same Member State X; to the total sum of loans and advances to credit institutions and customers.

	Bank A	*Bank B*
This is calculated as follows:		
loans and advances to credit institutions		
and customers	5 000	500
within one (and the same) Member State X	15 000	500
	20 000	1 000
and		
the total sum of loans and advances to credit institutions		
and customers	80 000	5 000

For

Bank A: 10 000 multiplied by (20 000 : 80 000) = 2 500

Bank B: 600 multiplied by (1 000 : 5 000) = 120

Result:

50 % of bank A's and 40 % of bank B's Community-wide turnover are achieved in one (and the same) Member State X.

III. **Conclusion:**

Since

(a) the aggregate worldwide turnover of bank A plus bank B is more than ECU 5 000 million;

(b) the Community-wide turnover of each of the banks is more than ECU 250 million; and

(c) each of the banks achieve less than two-thirds of its Community-wide turnover in one (and the same) Member State,

the proposed merger would fall under the scope of the Regulation.

GUIDANCE NOTE II

CALCULATION OF TURNOVER FOR INSURANCE UNDERTAKINGS

(Article 5 (3) (a))

For the calculation of turnover for insurance undertakings, we give the following example (proposed concentration between insurances A and B):

I. **Consolidated profit and loss account**

(in million ecu)

Income	Insurance A		Insurance B	
Gross premiums written	5 000		300	
— gross premiums received from Community residents:		(4 500)		(300)
— gross premiums received from residents of one (and the same) Member State X:		(3 600)		(270)
Other income:	500		50	
Total income:	5 500		350	

II. **Calculation of turnover**

1. *Aggregate worldwide turnover*

is replaced by the value of gross premiums written worldwide, the sum of which is ECU 5 300 million.

2. *Community-wide turnover*

is replaced, for each insurance undertakings, by the value of gross premiums written with Community residents. For each of the insurance undertakings, this amount is more than ECU 250 million.

3. *Turnover within one (and the same) Member State X*

   is replaced, for insurance undertakings, by the value of gross premiums written with residents of one (and the same) Member State X.

   For insurance A, it achieves 80 % of its gross premiums written with Community residents within Member State X, whereas for insurance B, it achieves 90 % of its gross premiums written with Community residents in that Member State X.

III. **Conclusion**

Since

(a) the aggregate worldwide turnover of insurances A and B, as replaced by the value of gross premiums written worldwide, is more than ECU 5 000 million;

(b) for each of the insurance undertakings, the value of gross premiums written with Community residents is more than ECU 250 million; but

(c) each of the insurance undertakings achieves more than two-thirds of its gross premiums written with Community residents in one (and the same) Member State X,

the proposed concentration would not fall under the scope of the Regulation.

GUIDANCE NOTE III

CALCULATION OF TURNOVER FOR JOINT UNDERTAKINGS

A. *CREATION OF A JOINT UNDERTAKING* (Article 3 (2))

In a case where two (or more) undertakings create a joint undertaking that constitutes a concentration, turnover is calculated for the undertakings concerned.

B. *EXISTENCE OF A JOINT UNDERTAKING* (Article 5 (5))

For the calculation of turnover in case of the existence of a joint undertaking C between two undertakings A and B concenred in a concentration, we give the following example:

I. **Profit and loss accounts**

(in million ecu)

Turnover	Undertaking A	Undertaking B
Sales revenues worldwide	10 000	2 000
— Community	(8 000)	(1 500)
— Member State Y	(4 000)	(900)

(in million ecu)

Turnover	Joint undertaking C
Sales revenues worldwide	100
— with undertaking A	(20)
— with undertaking B	(10)
Turnover with third undertakings	70
— Community-wide	(60)
— in Member State Y	(50)

II. **Consideration of the joint undertaking**

(a) The undertaking C is jointly controlled (in the meaning of Article 3 (3) and (4)) by the undertakings A and B concerned by the concentration, irrespective of any third undertaking participating in that undertaking C.

(b) The undertaking C is not consolidated by A and B in their profit and loss accounts.

(c) The turnover of C resulting from operations with A and B shall not be taken into account.

(d) The turnover of C resulting from operations with any third undertaking shall be apportioned equally amongst the undertakings A and B, irrespective of their individual shareholdings in C.

(e) Any joint undertaking existing between one of the undertakings concerned and any third undertaking shall (unless already consolidated) not be taken into account.

III. **Calculation of turnover**

(a) Undertaking A's aggregate worldwide turnover shall be calculated as follows: ECU 10 000 million and 50 % of C's worldwide turnover with third undertakings (i. e. ECU 35 million), the sum of which is ECU 10 035 million.

Undertaking B's aggregate worldwide turnover shall be calculated as follows: ECU 2 000 million and 50 % of C's worldwide turnover with third undertakings (i. e. ECU 35 million), the sum of which is ECU 2 035 million.

(b) The aggregate worldwide turnover of the undertakings concerned is ECU 12 070 million.

(c) Undertaking A achieves ECU 4 025 million within Member State Y (50 % of C's turnover in this Member State taken into account), and a Community-wide turnover of ECU 8 030 million (including 50 % of C's Community-wide turnover);

and undertaking B achieves ECU 925 million within Member State Y (50 % of C's turnover in this Member State taken into account), and a Community-wide turnover of ECU 1 530 million (including 50 % of C's Community-wide turnover.

IV. **Conclusion**

Since

(a) the aggregate worldwide turnover of undertakings A and B is more than ECU 5 000 million,

(b) each of the undertakings concerned by the concentration achieves more than ECU 250 million within the Community,

(c) each of the undertakings concerned (undertaking A 50,1 % and undertaking B 60,5 %) achieves less than two-thirds of its Community-wide turnover in one (and the same) Member State Y,

the proposed concentration would fall under the scope of the Regulation.

GUIDANCE NOTE IV

APPLICATION OF THE TWO-THIRDS RULE

(Article 1)

For the application of the two-thirds rule for undertakings, we give the following examples (proposed concentration between undertakings A and B):

I. **Consolidated profit and loss accounts**

EXAMPLE 1

(in million ecu)

Turnover	Undertaking A	Undertaking B
Sales revenues worldwide	10 000	500
— within the Community:	(8 000)	(400)
— in Member State X:	(6 000)	(200)

EXAMPLE 2 (a)

(in million ecu)

Turnover	Undertaking A	Undertaking B
Sales revenues worldwide	4 800	500
— within the Community:	(2 400)	(400)
— in Member State X:	(2 100)	(300)

EXAMPLE 2 (b)

same figures as in example 2 (a), BUT undertaking B achieves ECU 300 million in Member State Y.

II. Application of the two-thirds rule

EXAMPLE 1

1. *Community-wide turnover*

   is, for undertaking A, ECU 8 000 million and for undertaking B ECU 400 million.

2. *Turnover in one (and the same) Member State X*

   is, for undertaking A (ECU 6 000 million), 75 % of its Community-wide turnover and is, for undertaking B (ECU 200 million), 50 % of its Community-wide turnover.

3. *Conclusion*

   In this case, although undertaking A achieves more than two-thirds of its Community-wide turnover in Member State X, the proposed concentration would fall under the scope of the Regulation due to the fact that undertaking B achieves less than two-thirds of its Community-wide turnover in Member State X.

EXAMPLE 2 (a)

1. *Community-wide turnover*

   of undertaking A is ECU 2 400 million and of undertaking B, ECU 400 million.

2. *Turnover in one (and the same) Member State X*

   is, for undertaking A, ECU 2 100 million (i. e. 87,5 % of its Community-wide turnover); and, for undertaking B, ECU 300 million (i. e. 75 % of its Community-wide turnover).

3. *Conclusion*

   In this case, each of the undertakings concerned achieves more than two-thirds of its Community-wide turnover in one (and the same) Member State X; the proposed concentration would not fall under the scope of the Regulation.

EXAMPLE 2 (b)

Conclusion

In this case, the two-thirds rule would not apply due to the fact that undertakings A and B achieve more than two-thirds of their Community-wide turnover in different Member States X and Y. Therefore, the proposed concentration would fall under the scope of the Regulation.

I

(Acts whose publication is obligatory)

COMMISSION REGULATION (EC) No 3666/93

of 15 December 1993

amending Regulation No 27 and Regulations (EEC) No 1629/69, (EEC) No 4260/88, (EEC) No 4261/88 and (EEC) No 2367/90 with a view to implementing the competition provisions laid down in the Agreement on the European Economic Area

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to Council Regulation No 17 first Regulation implementing Articles 85 and 86 of the Treaty of 6 February 1962 [1], as last amended by the Act of Accession of Spain and Portugal, and in particular Article 24 thereof,

Having regard to Council Regulation (EEC) No 1017/68 of 19 July 1968 applying rules of competiton to transport by rail, road and inland waterway [2], as last amended by the Act of Accession of Greece, and in particular Article 29 thereof,

Having regard to Council Regulation (EEC) No 4056/86 of 22 December 1986 laying down detailed rules for the application of the Treaty to maritime transport [3], and in particular Article 26 thereof,

Having regard to Council Regulation (EEC) No 3975/87 of 14 December 1987 laying down the procedure for the application of the rules on competition to undertakings in the air transport sector [4], as last amended by Regulation (EEC) No 2410/92 [5], and in particular Article 19 thereof,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings [6], and in particular Article 23 thereof,

Having consulted the Advisory Committee on Restrictive Practices and Monopolies in the Transport Industry, the Advisory Committee on Agreements and Dominant Positions in the field of Maritime Transport, the Advisory Committee on Agreements and Dominant Positions in Air Transport and the Advisory Committee on Concentrations,

Whereas Regulation No 17 and Regulations (EEC) Nos 1017/68, 4056/86, 3975/87 and 4064/89 empower the Commission to adopt implementing provisions concerning the form, content and other details of applications, notifications and complaints, of which power the Commission has made use in Regulation No 27 [7], as last amended by Regulation 2526/85 [8], and in Regulations (EEC) No 1629/69 [9], (EEC) No 4260/88 [10], (EEC) No 4261/88 [11] and (EEC) No 2367/90 [12];

Whereas with the entry into force of the Agreement on the European Economic Area, and as laid down in the Protocol adjusting the Agreement on the European Economic Area, the Commission will be responsible for the implementation of the competition provisions laid down in that Agreement;

Whereas Protocol 21 to the Agreement on the European Economic Area provides that the Community shall, where necessary, adopt the provisions giving effect to the principles laid down in Article 1 (2) (e) and Articles 53 to 60 of that Agreement;

Whereas to enable the Commission to properly fulfil its obligations under the Agreement on the European Economic Area, it is necessary to modify the provisions relating to the form, content and other details of applications, notifications and complaints in order to simplify and accelerate consideration by the competent departments, in the interests of all concerned,

(1) OJ No 13, 21. 2. 1962, p. 204/62.
(2) OJ No L 175, 23. 7. 1968, p. 1.
(3) OJ No L 378, 31. 12. 1986, p. 4.
(4) OJ No L 374, 31. 12. 1987, p. 1.
(5) OJ No L 240, 24. 8. 1992, p. 18.
(6) OJ No L 395, 30. 12. 1989, p. 1.
(7) OJ No 35, 10. 5. 1962, p. 1118/62.
(8) OJ No L 240, 7. 9. 1985, p. 1.
(9) OJ No L 209, 21. 8. 1969, p. 1.
(10) OJ No L 376, 31. 12. 1988, p. 1.
(11) OJ No L 376, 31. 12. 1988, p. 10.
(12) OJ No L 219, 14. 8. 1990, p. 5.

HAS ADOPTED THIS REGULATION:

Article 1

Regulation No 27 is amended as follows:

1. Article 2 (1) is replaced by the following:

   '1. Fifteen copies of each application and notification shall be submitted to the Commission'.

2. The following paragraph 4 is added to Article 2:

   '4. Where applications and notifications are made pursuant to Articles 53 and 54 of the Agreement on the European Economic Area, they may also be in one of the official languages of the EFTA States or the working language of the EFTA Surveillance Authority'.

3. The Annex referred to in Article 4 (1) is replaced by Appendix 1 to this Regulation.

4. Form C is replaced by Appendix 1 a to this Regulation.

Article 2

Regulation (EEC) No 1629/69 is amended as follows:

1. Article 3 (5) is replaced by the following:

   '5. Fifteen copies of each application or notification and of the supporting documents shall be submitted to the Commission'.

2. The following Article 3a is inserted:

   '*Article 3a*

   Where complaints, applications and notifications as provided for in Article 1 (1), Article 3 (1) and Article 3 (2) are made pursuant to Articles 53 and 54 of the Agreement on the European Economic Area, they may also be in one of the official languages of the EFTA States or the working language of the EFTA Surveillance Authority'.

3. The Annex referred to in Article 1 (1), Article 3 (1) and Article 3 (2) is replaced by Appendix 2 to this Regulation.

Article 3

Regulation (EEC) No 4260/88 is amended as follows:

1. Article 4 (4) is replaced by the following:

   '4. Fifteen copies of each application and of the supporting documents shall be submitted to the Commission'.

2. The following Article 4a is inserted:

   '*Article 4a*

   Where notifications, complaints and applications as provided for in Article 1 (3), Article 2 (1) and Article 4 (6) are made pursuant to Articles 53 and 54 of the Agreement on the European Economic Area, they may also be in one of the official languages of the EFTA States or the working language of the EFTA Surveillance Authority'.

3. The Annex referred to in Article 4 (1) is replaced by Appendix 3 to this Regulation.

Article 4

Regulation (EEC) No 4261/88 is amended as follows:

1. Article 3 (4) is replaced by the following:

   '4. Fifteen copies of each application and of the supporting documents shall be submitted to the Commission'.

2. The following Article 3a is inserted:

   '*Article 3a*

   Where complaints and applications as provided for in Article 1 (1) and Article 3 (6) are made pursuant to Articles 53 and 54 of the Agreement on the European Economic Area, they may also be in one of the official languages of the EFTA States or the working language of the EFTA Surveillance Authority'.

3. The Annex referred to in Article 3 (1) is replaced by Appendix 4 to this Regulation.

Article 5

Regulation (EEC) No 2367/90 is amended as follows:

1. Article 2 (2) is replaced by the following:

   '2. Twenty-one copies of each notification and sixteen copies of the supporting documents shall be submitted to the Commission at the address indicated in form CO'.

2. The following paragraph 5 is added to Article 2:

   '5. Where notifications are made pursuant to Article 57 of the Agreement on the European Economic Area, they may also be in one of the official languages of the EFTA States or the working language of the EFTA Surveillance Authority. If the language chosen for the notifications is not an official language of the Community, the notifying parties shall simultaneously supplement all documentation with a translation into an official language of the Community. The language which is chosen for the translation shall determine the language used by the

Commission as the language of the proceedings for the notifying parties.'

3. The Annex referred to in Article 2 (1) is replaced by Appendix 5 to this Regulation.

Article 6

This Regulation shall enter into force on the date of entry into force of the Agreement on the European Economic Area.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 15 December 1993

For the Commission

Karel VAN MIERT

Member of the Commission

ANNEX

FORM CORRELATING TO THE NOTIFICATION OF A CONCENTRATION PURSUANT TO COUNCIL REGULATION (EEC) No 4064/89

A. Introduction

This form specifies the information to be provided by an undertaking or undertakings when notifying the Commission of a concentration with a Community dimension. A 'concentration' is defined in Article 3 and 'Community dimension' by Article 1 of Regulation (EEC) No 4064/89.

Your attention is particularly drawn to Regulation (EEC) No 4064/89, to Article 57 of the Agreement of the European Economic Area [1] (point 1 of Annex XIV to the EEA Agreement and Protocol 4 to the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice), to Commission Regulátion (EEC) No 2367/90 as well as to Protocols 21, 22 and 24 to the EEA Agreement and to Article 1, as well as the Agreed Minutes of the Protocol adjusting the Agreement on the European Economic Area. In particular you should note that:

(a) all information requested by this form must be provided. However if, in good faith, you are unable to provide a response to a question or can only respond to a limited extend on the basis of available information, indicate this and give reasons. If you consider that any particular information requested by this form may not be necessary for the Commission's examination of the case, you may ask the Commission to dispense with the obligation to provide that information, pursuant to Article 4 (3) of Regulation (EEC) No 2367/90;

(b) unless all sections are completed in full or good reasons are given explaining why it has not been possible to complete unanswered questions (for example, because of the unavailability of information on a target company during a contested bid) the notification will be incomplete and will only become effective on the date on which all the information is received. The notification will be deemed to be incomplete if information is incorrect or misleading;

(c) incorrect or misleading information where supplied intentionally or negligently could make you liable to a fine;

(d) the notifications made by using Form CO issued by the Commission and Form CO issued by the EFTA side are equally valid.

B. Who must notify

In the case of a merger (within the meaning of Article 3 (1) (a) of Regulation (EEC) No 4064/89 or the acquisition of joint control in an undertaking within the meaning of Article 3 (1) (b) of Regulation (EEC) No 4064/89, the notification shall be completed jointly by the parties to the merger or by those acquiring joint control as the case may be.

In the case of the acquisition of a controlling interest in an undertaking by another, the acquirer must complete the notification.

In the case of a public bid to acquire an undertaking, the bidder must complete the notification.

Each party completing the notification is responsible for the accuracy of the information which it provides.

For the purposes of this form 'the parties to the concentration' ('the parties') includes the undertaking in which a controlling interest is being acquired or which is the subject of a public bid.

[1] Hereinafter referred to as 'the EEA Agreement'. In particular, any reference to EFTA States shall be understood to mean those EFTA States which are Contracting Parties to the EEA Agreement.

C. Supporting documentation

The completed notification must be accompanied by the following:

(a) copies of the final or most recent versions of all documents bringing about the concentration, whether by agreement between the parties concerned, acquisition of a controlling interest or a public bid;

(b) in a public bid, a copy of the offer document. If unavailable on notification it should be submitted as soon as possible and not later than when it is posted to shareholders;

(c) copies of the most recent annual reports and accounts of all the parties to the concentration;

(d) copies of reports or analyses which have been prepared for the purpose of the concentration and from which information has been taken in order to provide the information requested in Section 5 and 6;

(e) a list and short description of the contents of all other analyses, reports, studies and surveys prepared by or for any of the notifying parties for the purpose of assessing or analysing the proposed concentration with respect to competitive conditions, competitors (actual and potential), and market conditions. Each item in the list must include the name and position held of the author.

D. How to notify

The notification must be completed in one of the official languages of the European Community. This language shall thereafter be the language of the proceeding for all notifying parties. Where notifications are made in accordance with Article 12 of Protocol 24 to the EEA Agreement in an official language of an EFTA State which is not an official language of the Community, the notification and all supporting documents shall simultaneously be supplemented with a translation into an official language of the Community.

The information requested by this form is to be set out using the sections and paragraph numbers of the form.

Supporting documents shall be submitted in their original language; where this is not an official language of the Community they shall be translated into the language of the proceeding (Article 2 (4) of Regulation (EEC) No 2367/90).

The supporting documents may be originals or copies of the originals. In the latter case the notifying party shall confirm that they are true and complete.

The financial data requested in Section 2.4 must be provided in ecus at the average conversion rates prevailing for the years or other period in question.

Twenty-one copies of each notification and 16 copies of all supporting documents must be provided.

The notification should be sent to:

Commission of the European Communities,
Directorate-General for Competition (DG IV),
Merger Task Force (Cort. 150),
200 rue de la Loi,
B-1049 Brussels,

or be delivered by hand during normal Commission working hours at the following address:

Commission of the European Communities,
Directorate-General for Competition (DG IV),
Merger Task Force,
150 avenue de Cortenberg,
B-1040 Brussels.

E. Secrecy

Article 214 of the Treaty and Article 17 (2) of Regulation (EEC) No 4064/89 as well as Article 122 of the EEA Agreement, Article 9 of Protocol 24 to the EEA Agreement and Article 17 (2) of Chapter XIII of Protocol 4 to the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice (ESA Agreement) require the Commission, the Member States, the EFTA Surveillance Authority and the EFTA States, their officials and other servants not to disclose information they have acquired through the application of the regulation of the kind covered by the obligation of professional secrecy. The same principle must also apply to protect confidentiality as between notifying parties.

If you believe that your interest would be harmed if any of the information you are asked to supply was to be published or otherwise divulged to other parties, submit this information separately with each page clearly marked 'Business secrets'. You should also give reasons why this information should not be divulged or published.

In the case of merger or joint acquisitions, or in other cases where the notification is completed by more than one of the parties, business secrets may be submitted under separate cover, and referred to in the notification as an Annex. In such cases the notification will be considered complete on receipt of all the Annexes.

F. References

All references contained in this form are to the relevant articles and paragraphs of Regulation (EEC) No 4064/89.

Section 1

1.1. Information on notifying party (or parties)

Give details of:

1.1.1. name and address of undertaking;

1.1.2. nature of the undertaking's business;

1.1.3. name, address, telephone, fax and/or telex of, and position held by, the person to be contacted.

1.2. Information on other parties to the concentration [1]

For each party to the concentration (except the notifying party) give details of:

1.2.1. names and address of undertaking;

1.2.2. nature of the undertaking's business;

1.2.3. name, address, telephone, fax and/or telex of, and position held by, the person to be contacted.

1.3. Address for service

Give an address in Brussels, if available, to which all communications may be made and documents delivered in accordance with Article 1 (4) of Regulation (EEC) No 2367/90.

1.4. Appointment of representatives

Article 1 (2) of Regulation (EEC) No 2367/90 states that where notifications are signed by representatives of undertakings, such representatives shall produce written proof that they are authorized to act. Such written authorization must accompany the notification and the following details of the representatives of the notifying party or parties and other parties to the concentration are to be given below:

1.4.1. is this a joint notification?

1.4.2. if 'yes', has a joint representative been appointed?

if 'yes', please give the details requested in 1.4.3 to 1.4.6;

if 'no', please give details of the representatives who have been authorized to act for each of the parties to the concentration indicating whom they represent;

1.4.3. name of representative;

1.4.4. address of representative;

1.4.5. name of person to be contacted (and address if different from 1.4.4);

1.4.6. telephone, telefax and/or telex.

[1] This includes the target company in the case of a contested bid, in which case the details should be completed as far as is possible.

Section 2

Details of the concentration

2.1. Briefly describe the nature of the concentration being notified. In doing so state:

— whether the proposed concentration is a full legal merger, an acquisition, a concentrative joint venture or a contract or other means conferring direct or indirect control within the meaning of Article 3 (3) of Regulation (EEC) No 4064/89,

— whether the whole or parts of parties are subject to the concentration,

— whether any public offer for the securities of one party by another has the support of the former's supervisory boards, boards of directors or other bodies legally representing the party concerned.

2.2. List the economic sectors involved in the concentration.

2.3. Give a brief explanation of the economic and financial details of the concentration. In doing so provide, where relevant, information about the following:

— any financial or other support received from whatever source (including public authorities) by any of the parties and the nature and amount of this support,

— the proposed or expected date of any major events designed to bring about the completion of the concentration,

— the proposed structure of ownership and control after the completion of the concentration.

2.4. For each of the parties, the notifying party shall provide the following data for the last three financial years:

2.4.1. world-wide turnover (1);

2.4.2. Community-wide turnover (1) (2);

2.4.3. EFTA-wide turnover (1) (2);

2.4.4. turnover in each Member State (1) (2);

2.4.5. turnover in each EFTA State (1) (2);

2.4.6. the Member State, if any, in which more than two-thirds of Community-wide turnover is achieved (1) (2);

2.4.7. the EFTA State, if any, in which more than two-thirds of EFTA-wide turnover is achieved (1) (2);

2.4.8. profits before tax world-wide (3);

2.4.9. number of employees world-wide (4).

2.5. Provide the following information with respect to the last financial year;

2.5.1. does the combined turnover of the undertakings concerned in the territory of the EFTA States equal 25 % or more of their total turnover in the EEA territory?

2.5.2. does each of at least two undertakings concerned have a turnover exceeding ECU 250 million in the territory of the EFTA States?

(1) See Article 5 for the definition of turnover and note the special provisions for credit, insurance, other financial institutions and joint undertakings. For insurance undertakings, credit and other financial institutions, Community residents and residents of a Member State are defined as natural or legal persons having their residence in a Member State, thereby following the respective national legislation. The corporate customer is to be treated as resident in the country in which it is legally incorporated. The same rules apply as regards the notion of residents in the territory of the EFTA States. For the calculation of turnover, the notifying party should also refer to the examples: guidance note I for credit and other financial institutions; guidance note II for insurance undertakings; guidance note III for joint undertakings.

(2) See guidance note IV for the calculation of turnover in one Member State with respect to Community-wide turnover.

(3) 'Profit before tax' shall comprise profit on ordinary activities before tax on profit.

(4) Employees shall comprise all persons employed in the enterprise who have a contract of employment and receive remuneration.

Section 3

Ownership and control [1]

For each of the parties provide a list of all undertakings belonging to the same group. This list must include:

3.1. all undertakings controlled by the parties, directly or indirectly, within the meaning of Article 3 (3);

3.2. all undertakings or persons controlling the parties directly or indirectly within the meaning of Article 3 (3);

3.3. for each undertaking or person identified in 3.2, a complete list of all undertakings controlled by them directly or indirectly, within the meaning of Article 3 (3).

For each entry to the list the nature and means of control shall be specified:

3.4. provide details of acquisitions made during the last three years, by the groups identified above, of undertakings active in affected markes as defined in Section 5.

The information sought in this Section may be illustrated by the use of charts or diagrams where this helps to give a better understanding of the pre-concentration structure of ownership and control of the undertakings.

Section 4

Personal and financial links

With respect to each undertaking or person disclosed in response to Section 3 provide:

4.1. a list of all other undertakings which are active on affected markets (affected markets are defined in Section 5) in which the undertakings of the group hold individually or collectively 10 % or more of the voting rights or issued share capital. In each case state the percentage held;

4.2. a list of all other undertakings which are active on affected markets in which the persons disclosed in response to Section 3 hold 10 % or more of the voting rights or issued share capital. In each case state the percentage held;

4.3. a list for each undertaking of the members of their boards of management who are also members of the boards of management or of the supervisory boards of any other undertaking, which is active on affected markets; and (where applicable) for each undertaking a list of the members of their supervisory boards who are also members of the board of management of any other undertaking which is active on affected markets;

in each case stating the name of the other undertaking and the position held.

Information provided here may be illlustrated by the use of charts or diagrams where this helps to give a better understanding.

Section 5

Information on affected markets

The notifying party shall provide the data requested having regard to the following definitions:

Product markets

A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use.

A relevant product market may in some cases be composed of a number of individual product groups. An individual product group is a product or small group of products which present largely identical physical or technical characteristics and are fully interchangeable. The difference between products within the group will be small and usually only a matter of brand and/or image. The product market will usually be the classification by the undertaking in its marketing operations.

[1] See Article 3 (3), (4) and (5).

Relevant geographic market

The relevant geographic market comprises the area in which the undertakings concerned are involved in the supply of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because, in particular, conditions of competition are appreciably different in those areas.

Factors relevant to the assessment of the relevant geographic market include the nature and characteristics of the products or services concerned, the existence of entry barriers or consumer preferences, appreciable differences of the undertakings' market shares between neighbouring areas or substantial price differences.

Affected markets

Affected markets consist of relevant product markets or individual product groups in the EEA territory, in the common market, in the territory of the EFTA States, in a Member State or in an EFTA State or, where different, in any relevant geographic market where:

(a) two or more of the parties (including undertakings belonging to the same group as defined in Section 3) are engaged in business activities in the same product market or individual product group and where the concentration will lead to a combined market share of 10 % or more. These are horizontal relationships; or

(b) any of the parties (including undertakings belonging to the same group as defined in Section 3) is engaged in business activities in a product market which is upstream or downstream of a product market or individual product group in which any other party is engaged and any of their market shares is 10 % or more, regardless of whether there is not any existing supplier/customer relationship between the parties concerned. These are vertical relationships.

I. Explanation of the affected relevant product markets

5.1. Describe each affected relevant product market and explain why the products and/or services in these markets are included (and why others are excluded) by reason of their characteristics, their prices and their intended use.

5.2. List the individual product groups defined internally by your undertaking for marketing purposes which are covered by each relevant product market described under 5.1.

II. Market data on affected markets

For each affected relevant product market and, where different, individual product group, for each of the last three financial years:

(a) for the EEA territory;

(b) for the Community as a whole;

(c) for the territory of the EFTA States as a whole;

(d) individually for each Member State where the parties (including undertakings belonging to the same group as defined in Section 3) do business;

(e) individually for each EFTA State where the parties (including undertakings belonging to the same group as defined in Section 3) do business;

(f) and where different, for any relevant geographic market;

provide the following:

5.3. an estimate of the value of the market and, where appropriate, of the volume (for example in units shipped or delivered) of the market [1]. If available, include statistics prepared by other sources to illustrate your answer. Also provide a forecast of the evolution of demand on the affected markets;

5.4. the turnover of each of the groups to which the parties belong (as defined in Section 3);

5.5. an estimate of the market share of each of the groups to which the parties belong;

5.6. an estimate of the market share (in value and where appropriate volume) of all competitors having at least 10 % of the geographic market under consideration. Provide the name, address and telephone number of these undertakings;

[1] The value and volume of a market should reflect output less exports plus imports for the geographic market under consideration.

5.7. a comparison of prices charged by the groups to which the parties belong in each of the Member States and each of the EFTA States and a similar comparison of such price levels between the Community, the EFTA States and their major trading partners (e.g. the United States and Japan);

5.8. an estimate of the value (and where appropriate volume) and source of imports to the relevant geographic market;

5.9. the proportion of such imports that are derived from the groups to which the parties belong;

5.10. an estimate of the extent to which any of these imports are affected by any tariff or non-tariff barriers to trade.

III. Market data on conglomerate aspects

In the absence of horizontal or vertical relationship, where any of the parties (including undertakings belonging to the same group as defined in Section 3) holds a market share of 25 % or more for any product market or individual product group, provide the following information:

5.11. a description of each relevant product market and explain why the products and/or services in these markets are included (and why others are excluded) by reason of their characteristics, their prices and their intended use;

5.12. a list of the individual product groups defined internally by your undertaking for marketing purposes which are covered by each relevant product market described;

5.13. an estimate of the value of the market and the market shares of each of the groups to which the parties belong for each affected relevant product market and, where different, individual product group, for the last financial year:

(a) for the EEA territory as a whole;

(b) for the Community as a whole;

(c) for the territory of the EFTA States as a whole;

(d) individually for each Member State where the groups to which the parties belong do business;

(e) individually for each EFTA State where the groups to which the parties belong do business;

(f) and where different, for any relevant geographical market.

In each response in Section 5 the notifying party shall explain the basis of the estimates used or assumptions made.

Section 6

General conditions in affected markets

The following information shall be provided in relation to the affected relevant product markets and, where different, affected individual product groups.

Record of market entry

6.1. Over the last five years (or a longer period if this is more appropriate) has there been any significant entry to these markets in the Community or in the territory of the EFTA States? If the answer is 'yes', provide information on these entrants, estimating their current market shares.

6.2. In the opinion of the notifying party are there undertakings (including those at present operating only in extra-Community or extra EEA-markets) that could enter the Community's or EFTA's markets? If the answer is 'yes', provide information on these potential entrants.

6.3. In the opinion of the notifying party what is the likelihood of significant market entry over the next five years?

Factors influencing market entry

6.4. Describe the various factors influencing entry into affected markets that exist in the present case, examining entry from both a geographical and product viewpoint. In so doing take account of the following where appropriate:

— the total costs of entry (capital, promotion, advertising, necessary distribution systems, servicing, etc.) on a scale equivalent to a significant viable competitor, indicating the market share of such a competitor,

— to what extent is entry to the markets influenced by the requirement of government authorization or standard setting in any form? Are there any legal or regulatory controls on entry to these markets?

— to what extent is entry to the markets influenced by the availability of raw materials?

— to what extent is entry to the markets influenced by the length of contracts between an undertaking and its suppliers and/or customers?

— describe the importance of licensing patents, know-how and other rights in these markets.

Vertical integration

6.5. Describe the nature and extent of vertical integration of each of the parties.

Research and development

6.6. Give an account of the importance of research and development in the ability of a firm operating on the relevant market to compete in the long term. Explain the nature of the research and development in affected markets carried out by the undertakings to the concentration.

In so doing take account of the following where appropriate:

— the research and development intensities [1] for these markets and the relevant research and development intensities for the parties concerned,

— the course of technological development for these markets over an appropriate time period (including developments in products and/or services, production processes, distribution systems etc.),

— the major innovations that have been made in these markets over this time period and the undertakings responsible for these innovations,

— the cycle of innovation in these markets and where the parties are in this cycle of innovation,

— describe the extent to which the parties concerned are licensees or licensors of patents, know-how and other rights in affected markets.

Distribution and service systems

6.7. Explain the distribution channels and service networks that exist on the affected markets. In so doing take account of the following where appropriate:

— the distribution systems prevailing on the market and their importance. To what extent is distribution performed by third parties and/or undertakings belonging to the same group as the parties as disclosed in Section 3?

— the service networks (for example maintenance and repair) prevailing and their importance in these markets. To what extent are such services performed by third parties and/or undertakings belonging to the same group as the parties as disclosed in Section 3?

Competitive environment

6.8. Give details (names, addresses and contacts) of the five largest suppliers to the notifying parties and their individual share of the purchases of the notifying parties.

6.9. Give details (names, addresses and contacts) of the five largest customers of the notifying parties and their individual share of the sales of the notifying parties.

6.10. Explain the structure of supply and demand in affected markets. This explanation should allow the Commission further to appreciate the competitive environment in which the parties carry out their business. In so doing take account of the following where appropriate:

— the phases of the markets in terms of, for example, take-off, expansion, maturity and decline. In the opinion of the notifying party, where are the affected products in these phases?

[1] Research and development intensity is defined as research and development expenditure as a proportion of turnover.

— the structure of supply. Give details of the various identifiable categories that comprise the supply side and describe the 'typical supplier' of each category,

— the structure of demand. Give details of the various identifiable groups that comprise the demand side and describe the 'typical customer' of each group,

— whether public authorities, government agencies or State enterprises or similar bodies are important participants as sources of supply or demand. In any instance where this is so give details of this participation,

— the total Community-wide and EFTA-wide capacity for the last three years. Over the period what proportion of each of these capacities is accounted for by the parties and what have been their respective rates of capacity utilization?

Cooperative agreements

6.11. To what extent do cooperative agreements (horizontal and/or vertical) exist in the affected markets?

6.12. Give details of the most important cooperative agreements, research and development, specialization, distribution, long-term supply and exchange of information agreements.

Trade associations

6.13. List the names and addresses of the principal trade associations in the affected markets.

World-wide context

6.14. Describe the world-wide context of the proposed concentration indicating the position of the parties in this market.

Section 7

General matters

7.1. Describe how the proposed concentration is likely to affect the interests of intermediate and ultimate consumers, and the development of technical progress.

7.2. In the event that the Commission finds that the operation notified does not constitute a concentration within the meaning of Article 3 of Regulation (EEC) No 4064/89, do you request that the notification be treated as an application within the meaning of Article 2 or a notification within the meaning of Article 4 of Regulation No 17, as an application within the meaning of Article 12 or a notification within the meaning of Article 14 of Regulation (EEC) No 1017/68, as an application within the meaning of Article 12 of Regulation (EEC) No 4056/86 or as an application within the meaning of Article 3 (2) or 5 of Regulation (EEC) No 3975/87?

Section 8

Declaration

The notification must conclude with the following declaration which is to be signed by or on behalf of all the notifying parties.

The undersigned declare that the information given in this notification is correct to the best of their knowledge and belief, that all estimates are identified as such and are their best estimates of the underlying facts and that all the opinions expressed are sincere.

They are aware of the provisions of Article 14 (1) (b) of Regulation (EEC) No 4064/89.

Place and date: . . . . . .

Signatures:

COMMISSION

COMMISSION DECISION

of 12 April 1991

declaring the compatibility with the common market of a concentration

(Case No IV/MO42 — Alcatel/Telettra)

Council Regulation (EEC) No 4064/89

(Only the English text is authentic)

(91/251/EEC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertaking [1], and in particular Article 8 (2) thereof,

Having regard to the Commission Decision of 21 January 1991 to initiate proceedings in this case,

Having given the undertakings concerned the opportunity to make known their views on the obligations proposed by the Commission,

After consulting the Advisory Committee on Concentrations [2],

Whereas :

I. FACTS

The nature of the proceeding

(1) This proceeding concerns a proposed concentration which was notified on 10 December 1990 pursuant to Article 4 of Council Regulation (EEC) No 4064/89, consisting of the acquisition by Alcatel NV (Alcatel) from Fiat SpA (Fiat) of a controlling interest of 69,2 % of the shares of Telettra SpA (Telettra). Telettra will in turn acquire 100 % of Alcatel Face SpA, which is a subsidiary of Alcatel. Fiat will still own 25,4 % of Telettra. The balance of the shares in Telettra are currently owned by the Spanish telecommunications operator, Telefonica de España (Telefonica).

[1] OJ No L 395, 30. 12. 1989, p. 1, rectified vesion OJ No L 257, 21. 9. 1990, p. 13.

[2] OJ No C 127, 17. 5. 1991, p. 2.

The parties

(2) Alcatel is 70 % owned by Alcatel Alsthom Compagnie Générale d'Electricité (Alcatel Alsthom), formerly known as CGE. Alcatel is principally a supplier of telecommunications systems and equipment, and in 1989 had a worldwide turnover of ECU 12,8 billion. Alcatel Alsthom had a consolidated worldwide turnover of ECU 20,7 billion in 1989, the balance deriving mainly from the energy and transportation, nuclear, electrical engineering, and batteries sectors. The Community-wide turnover of Alcatel Alsthom in 1989 was ECU 16,5 billion. Not more than two-thirds was achieved in any one Member State.

(3) Telettra is principally a supplier of telecommunications systems and equipment. In 1989, it had a worldwide turnover of ECU 1,1 billion, ECU 0,95 billion of which arising in the Community. Not more than two-thirds of its Community-wide turnover was achieved in any one Member State.

The context of the agreement

(4) The agreement on the acquisition of control in Telettra is one of the components of the 'accord cadre' entered into between Fiat and Alcatel Alsthom. The other components of the 'accord cadre' are :

— the acquisition by Magneti Marelli, a subsidiary of Fiat, of a controlling interest in Alcatel Alsthom's batteries subsidiary, CEAG. This proposed concentration, which is subject to completion of the Alcatel/Telettra agreement, has been notified and is being dealt with separately under Case No IV/M043 [3],

[3] OJ No C 315, 14. 12. 1990, p. 14.

— the planned acquisition of a controlling interest in Fiat's railway equipment subsidiary, Fiat Ferroviaria, by GEC-Alsthom which is jointly controlled by GEC and Alcatel Alsthom,

— the creation of a European holding company which will be jointly owned by Fiat and Alcatel Alsthom, with the intention of developing initiatives of mutual interest in research and development.

The various components of the 'accord cadre' fall to be separately assessed under Regulation (EEC) No 4064/89 or Article 85 of the EEC Treaty.

The affected product markets

(5) Four product markets within the telecommunications systems and equipment sector are affected by the concentration, these being public switching, line transmission systems, microwave systems, and private switching.

These four markets represent 72 % of the total telecommunications equipment market which had a value of ECU 16,7 billion in the Community in 1989, including other telecommunications equipment areas such as radiotelephony, subsets, earth stations and telecommunications cables.

In terms of value, the most important telecommunications market is the market for public switching with a value of ECU 5,6 billion in 1989 which represents 34 % of the total telecommunications equipment market. In the same year, the market for line transmission systems had a value of ECU 3,9 billion (23 %), private switching a value of ECU 2 billion (12 %), and microwave systems a value of ECU 0,6 billion (3 %).

(6) Market shares of the parties and of their main competitors in these product markets in 1989 are reproduced in the Annex [1].

The public telecommunications equipment markets

(7) The telecommunications equipment supply industry is characterized by a steadily increasing and very high level of R&D expenditure, due to the increasing software content of telecommunications products and the shortening of product life cycles. Technically, Telettra fits in well with Alcatel's existing product base, and the acquisition gives Alcatel access to Telettra's cross-connect technology.

(8) Public switching, line transmission equipment and microwave equipment are largely public telecommunications equipment markets where the telecommunications operators are the only, or by far the most important, customers. The Spanish telecommunications operator, Telefonica, for example, is the only buyer in Spain of public switches, and buys 90 % of the line transmission equipment and currently 60 % of the microwave equipment in that Member State.

(9) Public telecommunications operators in principle operate diversified supplier policies which aim to strike a balance between creating and maintaining competition between suppliers on the one hand, and minimising costs arising from product differences on the other hand. For public switching, for example, it is generally not considered feasible to have more than two or three suppliers because of the high cost and technical complexity of this type of equipment. For transmission equipment, in general terms, it is usual to have more suppliers, say three to five, but there would still be a practical limit to the number which could be sustained.

(10) Procurement practices vary from one operator to another, and from one category of equipment to another, but are in principle based on a combination of negotiated contracts and tenders.

(11) Procurement practices of the Community telecommunications operators are evolving. Traditionally, in all Member States public networks were operated by State-owned telecommunications authorities which gave their orders for telecommunications equipment to a small group of national suppliers. This was often accompanied by specific national technical standards, which created adaptation costs for non-domestic suppliers.

(12) The actual pace of change in procurement policy varies quite significantly from one Member State to another. In this context, a process of liberalization and deregulation of the telecommunications sector has been initiated in the framework of the achievement of the single market. The Commission's directives on liberalization of telecommunications services, for example, aim to create more competition by breaking up the monopolies of the network

[1] This Annex constitutes business secrets which have been deleted in accordance with Article 20 (2) of Regulation (CEE) No 4064/89 for publication.

operators in the provision of services. On the supply side, directives on public procurement and on mutual recognition of terminal type approval aim to open markets to competitors from other Member States. Furthermore, there are efforts to achieve a Community-wide standardization of telecommunications equipment in the framework of European Telecommunications Standards Institute (ETSI).

(13) It is anticipated that the application of the provisions of Council Directive 90/531/EEC [1] on public procurement will contribute to further breaking down the traditional nationally-based buying policies of the telecommunications operators. Member States have to implement this Directive by 1 January 1993, with the exception of Spain, which must implement it by 1 January 1996, and Greece and Portugal by 1 January 1998.

(14) As to standardization of products in the markets under consideration, ETSI, which was set up in 1987, plans to issue 22 standards and 11 technical reports in the transmission area in its work programme for 1990 to 1993. Adoption of ETSI standards by the telecommunications operators in this area is voluntary for the time being, and commitment to this varies. However, from the date of implementation of Directive 90/531/EEC, use of European Telecommunications Standards (ETS) by telecommunications operators will be mandatory in the specification of their calls to tender.

(15) The extent of existing national specifications varies from one Member State to another and according to product. National specifications for transmission equipment for example are low or non-existent in Spain but quite significant in Italy.

The transmission markets in Spain

(16) Because of the significance of Alcatel and Telettra as competitors for the supply of line transmission equipment in Spain, the Commission has carried out a detailed enquiry as to the structural impact of the concentration in this Member State.

(17) Spain is at present the fastest growing telecommunications market in the Community, with overall growth expected to continue at around 5 % per annum in real terms for the next five years because of the modernization programme under way. In 1989 the value of the line transmission equipment market was ECU 531 million (13 % of the total Community market) and that of the microwave equipment market ECU 117 million (20 % of the Community market). Against the overall trend in the other telecommunications equipment markets, the microwave equipment market is generally declining.

Telefonica's ability to react to the concentration

(18) The telecommunications operator most concerned by the concentration, Telefonica, has raised no objection. Like other telecommunications operators, Telefonica has a diversified supplier policy so as not to be overly dependent on any one supplier. In its initial reply to the Commission's enquiries, Telefonica stated that it considered that the concentration between Alcatel and Telettra would not affect this policy.

(19) In response to the Commission's subsequent enquiries Telefonica has specified that its policy of diversified transmission equipment purchasing is based, *inter alia*, on the following principles:

— orders are placed on the basis of annual or two-yearly programmes and product suppliers are aware of invitations to tender for products. The factors taken into account in awarding contracts are quality, the delivery period, reliability and price,

— Telefonica is willing both to arrange any contacts that suppliers wish to have and to provide them with the information they deem necessary in order to be able to tender on an equal footing,

— new or potential suppliers may freely request technical approval of their products. Products which have successfully undergone technical testing are included in Telefonica's catalogue of suitable products which can be purchased. The ultimate choice of products is made in accordance with a combination of parameters, of which technical performance is one,

— an industrial presence in Spain will not henceforth be a decisive factor; it will, however, be necessary to maintain back-up in the country,

— the company's strategic plan for 1991 to 95 provides among other things for the opening-up of the market to new suppliers.

[1] OJ No L 297, 29. 10. 1990, p. 1.

(20) Telefonica has minority shareholdings in some of its suppliers. In particular, it has a shareholding of 21 % in Alcatel Standard Electrica SA which is a subsidiary of Alcatel, a shareholding of 10 % in Telettra Española SA, which is a subsidiary of Telettra, and a shareholding of 5,4 % in Telettra itself.

(21) An agreement which is conditional on the acquisition of Telettra by Alcatel has already been entered into whereby Alcatel will acquire Telefonica's 5,4 % shareholding in Telettra. The same agreement contains a provision whereby Alcatel has a call option to acquire Telefonica's shareholding in Telettra Española SA.

Furthermore, Telefonica has stated that there is no longer a strategic reason to retain minority shareholdings in its suppliers, and that it is willing to consider suitable offers.

(22) Accordingly, on 6 February 1991, Alcatel made the following commitments to the Commission:

— to acquire Telefonica's 5,4 % shareholding in Telettra when control in Telettra is acquired,

— to exercise the call option to acquire the 10 % shareholding of Telefonica in Telettra Espanila SA,

— to enter immediately into good faith negotiations with Telefonica so as to acquire at a fair price Telefonica's 21 % shareholding in Alcatel Standard Electrica SA.

Competitors' ability to react to the concentration

(23) American Telephone and Telegraph Company (AT&T) is the world's leading line transmission equipment supplier. It conducts its business in Spain through a joint venture company, AT&T-NS España, which was set up in 1987. This company is 51 % owned by AT&T and 49 % owned by Amper SA. The joint venture's first transmission sales were in 1988, with strong increases following in 1989 and 1990. AT&T-NS España today offers the full range of line transmission products in Spain.

AT&T considers that it is possible for it to sell a higher than anticipated level of transmission equipment in Spain. AT&T-NS España has the ability and spare capacity to do this, and AT&T could supply products from other subsidiaries into this market.

AT&T does not currently sell microwave transmission products in Spain. AT&T-NS España is said to continue to pursue public tender opportunities for microwave radio equipment.

(24) Telefonaktiebolaget LM Ericsson (Ericsson) is a Swedish company which, because of its relatively small domestic market base, has always been an active international competitor. Almost 50 % of its overall turnover now arises in Europe, excluding Sweden. Ericsson is already established in Spain. Although principally a supplier of public switching equipment to Telefonica, it also supplies digital transmission equipment products. Ericsson considers that it could strengthen the existing product offering, and easily expand local capacity if necessary, or supply products from other subsidiaries.

Ericsson currently has limited sales of a small capacity short distance radio link in the microwave equipment market in Spain. It states that it is intended to develop its position in this Member State and that essentially there is no product adaptation requirement for further development.

(25) Siemens currently has only a marginal position in the transmission markets in Spain, accounted for by sales of around ECU 10 million of microwave equipment in 1989. Siemens is the third largest telecommunications equipment supplier worldwide, just behind Alcatel and AT&T, and is therefore a significant potential competitor for the transmission markets in Spain.

In response to the Commission's enquiries, Siemens considers that there are currently two important trade barriers to the Spanish markets. These are the vertical integration of Telefonica with suppliers, and the fact that Directive 90/531/EEC on public procurement does not have to be applied in Spain until 1996.

(26) Alcatel in its notification cites the possibility of significant entry into the Community's markets by other large companies, notably Northern Telecom of Canada, and Fujitsu and NEC of Japan. For these companies however, the costs of product adaptation are substantial, since there are currently substantial differences in technical specifications.

II. LEGAL ASSESSMENT

Concentration

(27) The notified operation is a concentration within the meaning of Article 3 (1) (b) of Regulation (EEC) No 4064/89 since by acquiring 69,2 % of the shares in Telettra, Alcatel will acquire control of Telettra.

Community dimension

(28) The thresholds of Article 1 (2) of Regulation (EEC) NBo 4064/89 are met since the combined aggregate worldwide turnover of Alcatel Alsthom and Telettra is more than ECU 5 billion and the aggregate Community-wide turnover of each is more than ECU 250 million, of which not more than two-thirds is achieved within one and the same Member State. The concentration therefore has a Community dimension.

Compatibility with the common market

(a) *Relevant product markets*

(29) The concentration leads to an increase in market shares in four markets: public switching, line transmission equipment, microwave equipment and private switching. Each of these markets is a relevant product market for the purposes of assessment under Regulation (EEC) No 4064/89.

(b) *Geographical markets*

(30) It is considered that up to now the telecommunications markets in the Community have been largely fragmented in national markets. The main reasons for this have been, *inter alia:*

— the operation of the public networks by national telecommunications authorities which have traditionally given their orders for telecommunications equipment to a small group of national suppliers, and

— different national standards which created high costs of adaptation for non-domestic suppliers.

This situation is evolving as described in recitals 7 to 15 above.

(31) In very broad terms, standardisation is progressing faster for transmission equipment than for public switching for example. Furthermore, the replacement of analogue technology by digital will further break down some of the existing technical barriers in the medium to long term.

(32) Although it is anticipated that in the medium term the technical barriers will become less significant, the actual pace of change of commercial policy of the network operators varies substantially from one Member State to another.

(33) The combination of Alcatel and Telettra has a significant impact on competition only on the transmission markets in Spain. It is sufficient therefore to examine whether the Spanish markets have to be considered as relevant geographical markets.

(34) The most significant structural characteristics up to now have been that:

— the Spanish telecommunications operator, Telefonica, traditionally purchased from locally established suppliers, although this has started to change

— there is no legal obligation in Spain for the next five years to apply the procurement procedures provided for in Directive 90/531/EEC on public procurement,

— there are vertical links between Telefonica and its major equipment suppliers and in particular Alcatel and Telettra, by means of minority shareholdings. Vertical links between telecommunications operators and their suppliers can distrot normal conditions of competition by giving those suppliers a privileged position on the market. This can be the case even where telecommunications operators only have minority shareholdings, since such links would normally put other suppliers without such links at a disadvantage.

(35) Given the current structural characteristics of the transmission markets in Spain, it is concluded that Spain has to be considered as a separate relevant geographical market, for the purpose of assessing whether the concentration could give rise to a dominant position which would significantly impede effective competition within the meaning of Article 2 (2) of Regulation (EEC) No 4064/89.

(c) *Impact of the proposed concentration*

Overall impact

(36) For public switching, there is an impact only in Italy, where Alcatel and Telettra together would have 21 % of the market based on 1989 figures. Since Italtel is by far the leading competitor on the Italian market, having maintained a market share of 50 % for the last few years, the creation of a dominant position for the combined entity in this product market by the concentration is excluded, even if Italy were to be considered the relevant geographic market.

For private switching, Telettra is not a significant competitor in any Member State since it has a marginal presence only on the Italian market. The concentration produces no significant structural effect on either the Italian or wider Community market.

Accordingly, only the impact of the concentration on the markets for line transmission equipment and microwave equipment (the transmission markets) in Spain has to be considered.

Transmission markets in Spain

(37) On the basis of the actual market shares of Alcatel and Telettra in 1989, the concentration leads to very high combined market shares on the transmission markets in Spain for the new entity, because the two companies are the two current principal suppliers to Telefonica.

The figures are as follows:

— line transmission equipment: Alcatel 40 %, Telettra 41 %,

— microwave equipment: Alcatel 18 %, Telettra 65 %.

Contestability of the transmission markets

(38) A very high share of any market could indicate that a dominant position exists. Such an indication in the case of a supplier may nevertheless be countered, for example by the buying power of a monopsonistic purchaser.

In the present case, the high market shares of Alcatel and Telettra in the transmission markets in Spain result from Telefonica's choice of these companies as its main suppliers. This choice was however made on the basis of Alcatel and Telettra being active competitors in the past.

(39) Since Telefonica has maintained a diversified purchasing policy up to now, it is not probable that the new combined entity will sustain the same market share as achieved by the parties as competitors.

(40) It is possible for Telefonica to increase its purchases from other suppliers of transmission equipment in order to prevent any dependence on the new entity.

AT&T is immediately capable of increasing its deliveries across the entire range of line transmission equipment products. AT&T is not yet supplying microwave products in Spain, but AT&-NS España is continuing to pursue some public tender opportunities.

Although Ericsson does not cover the whole range of line transmission products, it is capable of increasing deliveries of digital products, these products being the most important segment for new installations. Ericsson currently has only limited sales of microwave equipment in Spain. It has stated however that it is intended to develop its position in that Member State.

The two principal actual competitors are therefore capable of increasing supply.

(41) Furthermore, it would seem possible for some competitors not currently present to a significant extent in Spain to become suppliers in the changed environment. Although the procedures envisaged in Directive 90/531/EEC on public procurement do not have to be introduced yet, Telefonica has stated that:

— it is willing both to arrange any contacts that suppliers wish to have and to provide them with the information they deem necessary in order to be able to tender on an equal footing,

— new or potential suppliers may freely request technical approval of their products. Products which have successfully undergone technical testing are included in Telefonica's catalogue of suitable products which can be purchased. The ultimate choice of products is made in accordance with a combination of parameters, of which technical performance is one,

— an industrial presence in Spain will not henceforth be a decisive factor.

(42) On this basis, there would be no significant barrier from the demand side for strong competitors such as Siemens to enter into Spain. Siemens is already present to some extent in the microwave equipment market.

The technical costs of adaptation do not today in themselves constitute an appreciable barrier to entry for European-based competitors. There is no indication either for the time being that proprietary intellectual property rights could be exploited in such a way as to amount to a barrier to such competitors. Within the framework of standardization in ETSI the Commission has a strong interest in preventing such a barrier emerging.

(43) Consequently, as to competitors not hitherto based in Europe, such as Northern Telecom, Fujitsu and NEC, it is not necessary to determine whether these are realistic potential competitors in Spain in the foreseeable future in the line transmission

equipment market. It is likely that a technical barrier to entry will remain until the Community's standardization programme comes into effect and Telefonica fully adopts the standards which will be defined by ETSI in this area. The North American and Japanese standards are currently significantly different from those adopted by the various European network operators. Once common European standards are defined and implemented, the necessary minimum volume to justify adaptation may become a more realistic possibility.

Structural links between Telefonica and the parties to the concentration

(44) In the context of the present case, the participation of Telefonica in the capital of Alcatel and Telettra, given their strong position on the transmission markets in Spain, is considered to amount to a barrier for other competitors.

(45) Alcatel has entered into a commitment *vis-à-vis* the Commission whereby Alcatel will acquire from Telefonica the minority shareholdings in Telettra and Telettra España SA and will enter into negotiations to acquire from Telefonica the minority shareholding in Alcatel Standard Electrica SA. The vertical links between Telefonica and Telettra will therefore disappear and given Telefonica's willingness to consider appropriate offers, there is a probability that the vertical link between Telefonica and Alcatel will also be removed, given Alcatel's commitment in this respect.

(46) Alcatel's commitments relate to the removal of a significant structural barrier to the transmission markets in Spain, and it is considered necessary therefore for the Commission to ensure that these commitments are complied with as soon as possible after completion of the concentration by attaching appropriate obligations to its Decision.

(d) *Conclusion*

(47) For the reasons outlined above, it appears that competitors of Alcatel and Telettra are capable in the near future of increasing their supply to Telefonica in the transmission markets. Because of its diversified purchasing policy and removal of vertical links with Alcatel and Telettra, it also appears that Telefonica is capable in the near future of increasing its purchases from other suppliers.

(48) In these circumstances, it is not considered that the current high market shares of Alcatel and Telettra on the transmission markets in Spain will enable the new entity to behave to an appreciable extent independently of its competitors and main customer.

(49) The concentration does not therefore create or strengthen a dominant position as a result of which effective competition would be significantly impeded in the common market or a substantial part of it,

HAS ADOPTED THIS DECISION :

Article 1

Subject to the obligations defined in Article 2, the proposed concentration between Alcatel and Telettra is declared compatible with the common market.

Article 2

The following obligations are attached to this Decision :

(a) that Alcatel acquires Telefonica's 5,4 % shareholding in Telettra SpA upon the acquisition of control in Telettra SpA, and that Alcatel informs the Commission when this takes place ;

(b) that Alcatel exercises its call option to acquire the 10 % shareholding of Telefonica in Telettra Espanola SA as soon as this is possible, and at the latest within 12 months from the acquisition of control in Telettra, and that Alcatel informs the Commission when this takes place ;

(c) that Alcatel enters immediately into good faith negotiations with Telefonica so as to acquire at a fair price Telefonica's 21,14 % shareholding in Alcatel Standard Electrica SA, within one week of the closing of the agreement with Fiat to acquire Telettra, and that Alcatel informs the Commission when it has done so ;

- that Alcatel informs the Commission as soon as there is a successful outcome,
- where there is no successful outcome within three months, that Alcatel informs the Commission of the progress of the negotiations that are taking place, and updates this information subsequently every three months,

— that Alcatel, in the event of no successful outcome, or no successful outcome after 12 months have elapsed, provides the Commission with full details of the offer being made (including price and conditions) so as to enable the Commission to verify that the negotiations as defined above have been conducted in good faith;

(d) So as to ensure that the effect of the commitments is not neutralized, that Alcatel shall not sell to Telefonica shares in any company of the Alcatel group which has activities in the Community without prior approval from the Commission until such time as the Commission waives this obligation. This obligation ceases to have effect at the latest on the date of full implementation in Spain of Directive 90/531/EEC, which must take place by 1 January 1996.

Article 3

This Decision is addressed to:

Alcatel NV,
Paris Headquarters SA,
33, rue Emeriau,
F-75015 Paris

and

Telettra SpA,
19 Via E. Cornalia,
I-20124 Milano.

Done at Brussels, 12 April 1991.

For the Commission

Leon BRITTAN

Vice-President

II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 29 May 1991

declaring the compatibility of a concentration with the common market

(Case No IV/M043 — Magneti Marelli/CEAc) —

Council Regulation (EEC) No 4064/89

(Only the French text is authentic)

(91/403/EEC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings [1], and in particular Article 8 (2) thereof,

Having regard to the Commission Decision of 21 January 1991 to initiate proceedings in this case,

Having given the undertakings concerned the opportunity to make known their views on the objections raised by the Commission,

Having regard to the opinion of the Advisory Committee on Concentrations [2],

Whereas :

I. NATURE OF THE OPERATION

(1) A proposed concentration was notified on 10 December 1990 pursuant to Article 4 of Council Regulation No 4064/89, consisting of the acquisition by Sicind, a wholly-owned subsidiary of Fiat, from Samag, a wholly-owned subsidiary of Alcatel Alsthom Compagnie Générale d'Électricité (Alcatel Alsthom), formally known as CGE, of 50,1 % of the shares of the Compagnie européenne d'Accumulateurs (CEAc). Samag currently holds 98.4 % of the shares of CEAc.

II. THE PARTIES

(2) Fiat had a consolidated worldwide turnover of ECU 33,294 000 million in 1989. Its Community-wide turnover in 1989 was ECU 29,315 000 million of which 63 % was achieved in Italy. The Fiat group is active in particular in the automobile and industrial vehicles, agricultural machinery, road construction machines, automotive parts and electric components sectors as well as in a number of other diversified sectors. It is intended that control of CEAc will be exercised by Magneti Marelli, a subsidiary of Fiat. Magneti Marelli is a producer of automotive parts. Its worldwide turnover was ECU 2,560 000 million in 1989.

(3) CEAc is a producer of starter batteries, stationary batteries and traction batteries. It achieved a worldwide turnover of ECU 275 million in 1989 and a Community-wide turnover of ECU 252 million.

III. CONTEXT OF THE ACQUISITION

(4) The notified operation is one of the components of a 'framework agreement' entered into between Fiat and Alcatel Alsthom, the other main elements of which are as follows :

(1) OJ No L 395, 30. 12. 1989, p. 1, as amended in OJ No L 257, 21. 9. 1990, p. 13.
(2) OJ No C 209, 10. 8. 1991, p. 11.

— the exchange of minority shareholdings between Fiat and Alcatel Alsthom. Fiat will acquire 6 % of Alcatel Alsthom and Alcatel Alsthom 3 % of Fiat,

— the acquisition by Alcatel NV from Fiat SpA (Fiat) of a controlling interest of 69,2 % of the shares of Telettra SpA (Telettra). This concentration was authorized by the Commission subject to certain obligations, on 12 April 1991 (Case No IV/M042 — Alcatel/Telettra) [1],

— the planned acquisition of a controlling interest in Fiat's railway equipment subsidiary, Fiat Ferroviaria, by GEC-Alsthom, which is jointly controlled by GEC and Alcatel Alsthom,

— the creation of a European holding company which will be jointly owned by Fiat and Alcatel Alsthom, which will have the objective of developing initiatives of mutual interest in research and development.

(5) This Decision concerns only the concentration between Sicind/Magneti Marelli and CEAc.

IV. APPLICABILITY OF REGULATION (EEC) NO 4064/89

(6) The notified operation is a concentration within the meaning of Article 3 (1) (b) of Regulation (EEC) No 4064/89, since, by acquiring 50,1 % of the shares in CEAc, Sicind would acquire control of CEAc.

(7) The thresholds of Article 1 (2) of Regulation (EEC) No 4064/89 are met, since in 1989 the combined aggregate worldwide turnover of Fiat and CEAc was more than ECU 5 000 million and the aggregate Community-wide turnover of each was more than ECU 250 million, of which not more than two-thirds was achieved in 1989 within one and the same Member State.

V. RELEVANT PRODUCT MARKETS

(8) According to the notification, the concentration affects the lead batteries sector, which must be divided into four separate product markets : the traction battery market, the stationary battery market, the original equipment (OE) market for starter batteries and the replacement market for starter batteries.

(9) Traction batteries and stationary batteries, although both belonging to the industrial battery sector, differ from one another in terms of their technology, use and the customers for which they are intended.

(10) In the case of starter batteries, the distinction between the OE market, in which the product is sold to motor vehicle manufacturers, and the replacement market is based not so much on a difference in the product itself or in the function of the product, but on the fact that the conditions of competition in the replacement market differ significantly from those in the market for original equipment. Supply to the OE market requires high technical capacity, intense research and development, 100 % reliabilitiy of the products, just-in-time delivery and supply certification granted by the car manufacturers. The existence of two separate markets for starter batteries is generally accepted in the industry. The Court of Justice has already drawn the distinction between the OE market and the replacement market in the case of truck tyres (Case No 322/81, NV Nederlandsche Banden — Industrie Michelin v. Commission [1983] ECR 3461).

VI. IMPACT OF THE CONCENTRATION IN FRANCE AND ITALY

(11) In the case of stationary batteries and original equipment and replacement starter batteries, the concentration will result in an increase in market shares in France and Italy for the new entity.

(12) In the case of traction batteries, the concentration will have a direct impact only in Italy, since Magneti Marelli operates only in that Member State.

VII. DECISIONS TAKEN BY THE COMMISSION DURING THE PROCEEDINGS

(a) *The decision to initiate proceedings*

(13) After examination of the notification, the Commission concluded that, with the exception of the traction battery market, the notified operation raised serious doubts as to its compatibility with the common market. It therefore decided, on 21 January 1991, to initiate proceedings pursuant to Article 6 (1) (c) of Regulation (EEC) No 4064/89.

(b) *The statement of objections*

(14) Following investigations carried out amongst a broad range of undertakings operating in the affected markets as competitors or customers, the Commission sent the parties, on 22 February 1991, a statement of objections in which it raised objections regarding the replacement market for starter batteries in France and Italy.

[1] OJ No L 122, 17. 5. 1991, p. 48.

(15) At a later stage, the objections relating to the replacement market for starter batteries in Italy were withdrawn by the Commission, which found that the concentration entailed a small increase in market share and that significant competitors were present on the market.

(16) As regards the replacement market for starter batteries in France, the objections set out in the statement of objections may be summarized as follows :

(a) there are in France sufficiently homogeneous conditions of competition which differ appreciably from the conditions of competiton existing in the other Member States.

Two factors demonstrate this :

— as is evident from the information communicated by the parties and their competitors, manufacturers are able in France to charge, for the same types of batteries, different prices than those which they charge in the other Member States,

— the market shares of the manufacturers are very different in each Member State : thus, for example, CEAc has a market share of more than 40 % in France and a market share of less than 5 % in Germany.

These differences, which continue to exist despite the absence of any specific legal barriers, may be attributed to a range of causes :

— different requirements reflecting the different make-up of vehicle fleets and differences in the level of service required in the Member States,

— consumer preferences for well-known brands,

— major differences in the range of distribution channels, which entail costs for manufacturers having to adjust their commercial strategy to each country,

— the concentration of supply varies considerably from one Member State to another. The more supply is concentrated in one market, the more difficult it will be for actual or potential competitors to increase their market shares or to penetrate a market. The proposed concentration would mean a substantial increase in market shares in France, where the two parties already have the largest market shares ;

(b) the proposed concentration would give the new entity a dominant position, with the result that effective competition would be significantly impeded, because of the following factors :

— the market share of the new entity would amount to some 60 % in France,

— the gap in relation to the next largest competitor would be considerable (of the order of 40 %),

— in addition, the financial strength of the new entity and that of its parent companies, and its greater access to the lead market, would also have to be taken into consideration,

— lastly, the main competitors having strong positions on their respective national markets would be tempted to refrain from competing, in particular since price competition is unreasonable on a mature market on which little production capacity is available.

It does not seem that the above factors can be offset by purchasing strength that could counterbalance the power of the new entity, since the largest of the numerous customers of the new entity achieve only a fraction of the new entity's turnover.

(17) The parties made known, at a hearing, their disagreement with the Commission's analysis in its statement of objections.

(c) *The opinion of the Advisory Committee*

(18) The Advisory Committee on Concentrations met on 30 April 1991 and delivered an opinion which supported the Commission's analysis.

VIII. AMENDMENTS MADE TO THE PROPOSED CONCENTRATION

(19) However, Fiat has informed the Commission that it has independently decided to amend the strategy underlying its establishment in France.

It will for this purose, within an agreed period, undertake to reduce its majority holding in the capital of the Compagnie Française d'Électrochimie (CFEC) to 10 % and to reduce to one member its representation on the administrative or supervisory bodies of CFEC.

Before its acquisition by Magneti Marelli in 1990, CFEC was the second largest French battery manufacturer, concentrating its activities on starter batteries in France. It is well established on the French market, on which it has long-established business relationships and well-known brands. Virtually all of Magneti Marelli's market share in France, which was 18,4 % in 1990, is accounted for by the turnover of CFEC.

IX. IMPLICATIONS OF THE TRANSFER OF CFEC ON THE ANALYSIS OF THE COMPETITIVE SITUATION

(20) The transfer by Fiat of its majority holding in CFEC's capital constitutes an important change in the facts of the concentration and has an influence on the assessment of the concentration on the relevant replacement market of starter batteries.

As a result of the transfer, the two largest French undertakings in the starter battery market are no longer involved in a concentration with one another. Consequently, the effects of the concentration in respect of:

— the combining of their market shares,

— the combining of their distribution networks,

— the combining of the best known French brands in the hands of a single undertaking,

no longer apply.

This change in the facts of the proposed concentration leads the Commission to consider the concentration compatible with the common market,

HAS ADOPTED THIS DECISION:

Article 1

The proposed concentration between Sicind and CEAc is hereby declared compatible with the common market, subject to the obligations set out in Article 2.

Article 2

The following obligations are attached to this Decision:

(a) in accordance with a timetable agreed with the Commission, Fiat shall reduce its holding in the Compagnie Française d'Électro-chimie to 10 % and shall reduce to one member its representation on the administrative or supervisory bodies of the Compagnie Française d'Électro-Chimie;

(b) Fiat shall not then increase its holding in the Compagnie Française d'Électro-chimie above the level referred to in (a) without the Commission's agreement;

(c) for the purposes of this article, Fiat means:

(i) the Fiat group;

(ii) any company controlled by any part of the Fiat group;

(iii) any person acting on behalf of a company referred to in (i) and (ii).

Article 3

This Decision is addressed to:

Fiat SpA,
Corso Marconi 10,
I-10125 Torino;

Sicind SpA,
Corso Marconi 20,
I-10125 Torino;

Compagnie Européenne d'Accumulateurs (CEAc),
18 Quai de Clichy,
F-92111 Clichy Cedex.

Done at Brussels, 29 May 1991.

For the Commission

Leon BRITTAN

Vice-President

OPINION

of the Advisory Committee on Concentrations given at the fifth meeting on 30 April 1991 concerning a preliminary draft Decision relating to Case IV/M.043 — Magneti Marelli/CEAc (1)

(91/C 209/08)

1. The Committee agrees with the Commission that the concentration Sicind (Magneti Marelli)/CEAc has Community dimension in accordance with the criteria given in Article 1 of the Merger Regulation.

2. A majority of the Committee shares the conclusion drawn by the Commission that the relevant product market is the replacement market for starter batteries, agreeing it is demonstrated that:

— the markets for starter batteries can be distinguished from those for traction batteries and stationary batteries,

— conditions of competition on the market for replacement batteries differ significantly from original starter batteries.

3. The majority is in agreement with the Commission that the relevant geographical market is France for the reasons given in the preliminary draft Decision. It results from a number of structural differences in the various Member States which establish appreciably different conditions of competition in the country concerned.

4. The majority endorse the view of the Commission that this concentration will create a dominant position on the market for replacement starter batteries, which will impede significantly effective competition in France as a substantial part of the common market, given that:

— Magneti Marelli/CEAc will obtain a market share in France of about 60 %,

— neither the competitors not the clients will be able or willing to control the scope of action of the new entity,

— the financial strength of the parties to the concentration will be substantially increased in comparison with the competitors.

The proposed concentration is therefore not compatible with the common market.

5. A minority of the Committee considers that:

— the Commission's analysis of the geographical reference market takes insufficient account of factors which tend to establish that the French market for replacement batteries is less isolated within national boundaries, in particular by reason of the specific characteristics which the French market displays (power of buyers and weakness of national preferences),

— the operation is not of a kind to create a dominant position on the French market or to significantly impede in a lasting manner the operation of competition on this market, for the following reasons: despite the strong market shares acquired by the new entity, the French market would remain contestable after the concentration, in particular because of not only the existence of active and powerful competition but also the absence of barriers to access to the market.

A minority further considers that, in the absence of an agreed settlement in the case, a decision of incompatibility, would not be in accordance with the principle of proportionality, in that the objections raised by the Commission concern only less than one-fifth of the overall transaction.

A minority encourages the Commission to display readiness to receive proposals for undertakings from the parties.

6. The Committee asks the Commission to take account of the other points raised during discussion of the case.

7. The Committee recommends that this opinion is published.

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(1) OJ No L 222, 10. 8. 1991.

II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 19 July 1991

declaring the compatibility with the common market of a concentration

(Case No IV/M068 — Tetra Pak/Alfa-Laval)

Council Regulation (EEC) No 4064/89

(Only the English text is authentic)

(91/535/EEC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings (1), and in particular Article 8 (2) thereof,

Having regard to the Commission Decision of 19 March 1991 to initiate proceedings in this case,

After consulting the Advisory Committee on Concentrations (2),

Whereas :

I. THE NATURE OF THE PROCEEDING

This proceeding concerns a concentration which was notified to the Commission pursuant to Article 4 of Council Regulation (EEC) No 4064/89. The notification became effective on February 18 1991. The concentration consists of the proposed acquisition by Tetra Pak International SA of all the share capital of Alfa-Laval AB by way of public bid.

II. THE PARTIES

In 1989, the last financial year for which figures are available, Tetra Pak (Switzerland) had a world-wide turnover of ECU 3 218 million, of which ECU 1 645 million was generated in the Community. Tetra Pak's activity is limited to systems for packaging liquid food products.

Two main categories of liquid packaging machines are produced by Tetra Pak : those used for packaging liquid under aseptic (sterile) conditions, and those used for packaging liquid for pasteurized milk and freshly squeezed fruit juice.

Alfa-Laval AB is a Swedish company, quoted on the Stockholm stock exchange. In 1989, the last year for which figures are available, it had a world-wide turnover of ECU 2 145 million, of which ECU 780 million was generated in the Community.

Alfa-Laval is one of the world's leading manufacturers of processing equipment. Its activities may be divided into three separate areas :

— *industry:* Alfa-Laval produces five main types of industrial processing equipment : automation, dosing and analysing, flow equipment, separation and thermal equipment ;

(1) OJ No L 395, 30. 12. 1989, p. 1, rectified version OJ No L 257, 21. 9. 1990, p. 13.
(2) OJ No C 275, 22. 10. 1991, p. 6.

— *food:* Alfa-Laval produces almost all types of machines used in the food-processing industry. These products are used for the manufacture, storage, pasteurization, etc. of dairy products, fruit juices, oils and fats, wines and beers, fish and meat and a wide range of other foods;

— *agricultural equipment*: Alfa-Laval is a leading producer of processing and control equipment in this sector.

III. CONCENTRATION WITH A COMMUNITY DIMENSION

The implementation of Tetra Pak's public bid to purchase the entire share capital of Alfa-Laval would constitute a concentration within the meaning of Article 3 (1) (b) of Regulation (EEC) No 4064/89, hereinafter referred to as the Regulation. The thresholds set out in Article 1 (2) of the Regulation are also met, and the parties do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension.

IV. ANALYSIS

A. Introduction

The Commission has examined the horizontal and vertical relationships between the product ranges of Alfa-Laval and Tetra Pak. These are limited to the following:

— the only horizontal effect that would result from the concentration relates to the packaging of liquid soups. Both companies have a process capable of being used for this operation;

— in vertical terms, Alfa-Laval sells technical engineering services for the machine industry, stainless steel pipes, valves and clamps, and heat exchangers. These products are used by Tetra Pak in the manufacture of its packaging machines.

Due to the very limited overlap between these two companies in these respects and their very limited market positions in the sectors identified above, the Commission considers that in relation to the horizontal and vertical overlap between the product ranges of the two companies the operation does not raise any problems with regard to its compatibility with the common market.

However, although technically speaking the vertical relationships between Tetra Pak and Alfa-Laval are limited to those set out above, the two companies do produce equipment that has a certain complementarity from the point of view of the consumer. Alfa-Laval produces all equipment used for processing milk and juice until it is packaged. Tetra Pak produces the machines used to package the milk/juice. The merged undertaking would therefore be able to offer a fuller product range now covering all machines used by the dairy/juice producer.

The need to fully determine the nature and extent of the potential effects flowing from this vertical complementarity was the reason leading the Commission to open proceedings in this case, pursuant to Article 6 (1) (c) of the Regulation, on March 19 1991. In particular, in the decision opening proceedings, the Commission identified the following matters which required in-depth investigation:

(i) if the ability to offer a fuller product range than its actual or potential competitors constituted a significant advantage to Tetra Pak in its future sales of packaging machines, this might create or strenghten dominant positions on the markets for such machines and their respective cartons. This question was considered to merit particularly careful scrutiny given Tetra Pak's existing very high market shares in the various markets for packaging and cartons;

(ii) in its sales of milk/juice processing equipment the merged company would also acquire the possibility of offering a fuller product range, including both processing and packaging equipment. Were this to constitute a significant advantage when selling processing equipment the operation might create or strengthen dominant positions on the markets for the various types of processing machines.

B. Effects of the concentration on Tetra Pak's operations

1. *Introduction*

The Commission has examined the effects of the concentration on the following markets in which Tetra Pak is active. The Commission considers that these markets constitute relevant product markets for the purpose of analysing the concentration pursuant to the Regulation:

— the market for machines used for the packaging of liquid foods in cartons under aseptic conditions and the market for the cartons used by such machines;

— the market for machines used for the packaging of liquid foods in cartons under non-aseptic conditions and the market for the cartons used by such machines.

2. *Definition of the relevant market*

Aseptic packaging machines using cartons are technically advanced machines that are able to package aseptic liquids or semi-liquids into carton boxes whilst ensuring that no micro-organisms are introduced into the liquid in question. The machines are at present used to a large extent to package milk treated by the UHT (Ultra high temperature) process and aseptically treated juices.

Possible substitutes for such machines that have been examined by the Commission are the following:

— aseptic packaging machines using other packaging mediums such as glass or plastic;

— non aseptic packaging machines using carton, glass or plastic.

These are the closest possible substitutes for the market as defined. If these products do not form part of the relevant market for the purposes of the examination of the notification it is unnecessary to examine even less perfect substitutes for the product such as metal cans.

In order to assess whether the above mentioned possible substitutes for aseptic carton packaging machines in fact constitute reasonable alternatives, the Commission has undertaken a widespread inquiry. This has involved the sending of a detailed questionnaire to a large number of dairies situated throughout the Community as well as the principal competitors of Alfa-Laval and Tetra Pak and to Alfa-Laval and Tetra Pak themselves.

2.1. Non-aseptic packaging machines are not reasonable substitutes for aseptic packaging machines

The following elements show that the demand elasticity between these two categories is low, and thus they do not represent reasonable substitutes for each other:

(i) Nature of the end-product: shelf-life

Liquids that are packaged aseptically will have a much longer shelf-life than those packaged non-aseptically. Typically aseptic milk will last six months whilst non-aseptically treated milk will last less than one month.

(ii) Distribution method

The difference in the shelf-life and stability between the aseptically and non-aseptically packaged product has significant repercussions on distribution methods. Non-aseptically packaged juice and milk must at all times be kept refrigerated. Aseptically packaged products require no such care. This is one reason why it is very difficult for purchasers of the end product to switch orders from aseptically packaged products to non-aseptic ones in the short to medium term in response to a small but significant price rise. To undertake such a substitution they would also have to invest in new or additional refrigerated distribution and/or sales facilities.

(iii) Taste

Non-aseptically packaged liquids are more expensive than aseptically packaged ones due largely to higher distribution, storage, wastage and display costs. This is an indication that the nature of the finished product in taste terms and not the nature of the packaging process is of principal importance to a purchaser of the final product.

(iv) The packaging process accounts for no more than 10 % of final product price for milk and juice. Thus, a 10 % rise in the total cost of packaging (machine and carton) could result in only a 1 % price increase in the final product price. As explained above, final customers and retailers view aseptic and non-aseptic end products only to a partial extent substitutable for each other, *inter alia* for reasons not connected to price. Thus, a very large price rise in packaging cost for aseptic systems would be necessary to cause a significant shift in demand by retailers from aseptic liquid to non-aseptic liquid and thereby in due course from aseptic packaging machines to non-aseptic machines.

(v) As part of its investigations the Commission asked a large number of dairies and aseptic and non-aseptic packaging machine suppliers to state the expected response to an increase in price in the aseptic packaging machine sector in general. Their replies indicate that the price-elasticity of demand between aseptic and non-aseptic packaging machines is very low. Over 75 % of respondents considered that a price increase of greater than 20 % would be necessary to lead them to change future purchasing plans from aseptic to non-aseptic packaging systems.

In the light of the above the Commission concludes that non-aseptic packaging machines do not represent a realistic and reasonable substitute for aseptic packaging machines.

2.2. Aseptic packaging machines using packaging mediums other than carton are not reasonable substitutes for carton-based systems

Aseptic liquids packaged in cartons represent over 90 % of total aseptically packaged liquids. However, it is possible to package aseptic liquids in plastic or glass. Thus the Commission has examined to what extent these packaging methods represent reasonable substitutes for carton aseptic packaging. All the information available to the Commission indicates that these products do not form part of the relevant product market or markets for the purposes of this case and represent rather imperfect substitutes for carton packaging systems. The reasons for this are as follows:

(i) Physical characteristics of the package

Carton-packaged aseptic products are produced in 'bricks' (rectangular) form. This means that they can be transported, displayed and stored in a much smaller area than glass or plastic bottles. Furthermore, as a carton package is much lighter than a glass bottle, and takes up less space than a glass or plastic bottle, transport costs are lower for carton than for glass or plastic packaging.

(ii) Environmental concerns

Glass bottles might be considered to benefit from a better environmental profile than cartons. The Commission has therefore examined whether one might expect carton packaging systems to be replaced by glass bottling systems in the foreseeable future for environmental reasons and has concluded that this will not be the case. Replies to the Commission's questionnaire indicate that purchasers/lessees and producers of packaging machines do not expect such substitution in the near future.

(iii) As explained above, packaging costs represent a small part of the total retail cost of aseptically packaged liquids. Thus, a decision by a retailer to purchase a liquid packaged in one or other medium will therefore be affected to a limited extent by a small but significant price increase in carton aseptic packaging systems.

(iv) Dairies and packaging machine manufacturers were asked a number of questions to determine the extent to which a significant price rise in aseptic carton packaging systems would result in a significant demand shift to non-carton aseptic packaging systems. The replies indicate that the demand price-elasticity between these product categories is very low. Over 75 % of respondents considered that a price increase of greater than 20 % would be necessary to lead them to change future purchasing plans from aseptic carton to aseptic glass or plastic packaging systems.

In the light of the above, the Commission concludes that aseptic plastic and glass packaging machines do not constitute part of the same product market as aseptic carton packaging machines for the purpose of the examination of the notification.

2.3. The geographic reference market

Aseptic packaging machines of Tetra Pak and its principal competitor, PKL Verpackungssysteme GmbH, are sold throughout the Community. As far as the Commission is aware there are no significant differences in the type and nature of the machines that Tetra Pak and PKL supply in different parts of the Community. Similar distribution systems are used by the companies for their machines throughout the Community. The Commission therefore concludes that the conditions of competition throughout the Community for the products in question are sufficiently homogeneous to assume that the geographic reference market for the purpose of examining the concentration is the Community as a whole.

3. *Dominant position*

3.1. Introduction

In determining whether Tetra Pak holds a dominant position on the relevant product markets as defined above, the Commission has examined a number of factors set out in Article 2 (1) of the Regulation as pertinent to such an analysis.

3.2. Market shares

Tetra Pak has at present a market share exceeding 90 % of the market for the leasing/sale of aseptic carton packaging machines. Tetra Pak has held such a market share for a considerable period of time.

3.3. Size and importance of existing competitors

A market share as high as 90 % is, in itself, a very strong indicator of the existence of a dominant position. However, in certain rare circumstances even such a high market share may not necessarily result in dominance. In particular, if sufficiently active competitors are present on the market, the company with the large market share may be prevented from acting to an appreciable extent independently of the pressures typical of a competitive market.

The Commission has identified only one actual competitor of Tetra Pak on the relevant market, PKL. However, PKL is a small company with limited financial and material assets. Thus, even were PKL to be considered as an effective competitor of Tetra Pak, it would be unable to meet orders in the short term for a significant part of the market. The inability to act quickly to a change in demand limits PKL's role as a real restraint on Tetra Pak's commercial freedom. Furthermore, the machines of Tetra Pak and PKL are significantly different in technical terms. In particular, Tetra Pak's continuous roll machine offers increased convenience in handling carton blanks for packaging liquids but is unable to package liquids containing particulates.

3.4. Supply-side substitutability — barriers to entry

The Commission has also examined the potential entrants into the relevant product and geographic reference market, to determine whether the threat of entry is sufficiently intense to deprive Tetra Pak of the ability to act to an appreciable extent independently of the market pressure that is characteristic of dominance.

Although the Commission has identified at least one potential entrant it considers that the barriers to entry are sufficiently high to prevent that, and other, potential entrants from significantly limiting Tetra Pak's freedom of action, at least in the short term. The reasons for this view are as follows:

— Tetra Pak owns many patents useful for the production of an aseptic carton packaging machine. These valuable patents are not available to other potential entrants;

— replies to the Commission's questionnaire indicate that one of the factors foremost in the mind of a potential purchaser of a carton aseptic packaging machine in deciding which machine to purchase is whether the manufacturer in question has a proven track record. Because a breakdown in a packaging machine's sterility can lead to the production of unsaleable milk involving considerable financial loss before the fault becomes apparent, a machine manufacturer's ability to demonstrate a proven track record regarding the sterility of the end product is very important. Replies to the questionnaire indicate that the dairies consider Tetra Pak to have such a proven track record. This will make it very difficult, at least in the short term, for a new manufacturer to enter the market;

— a carton aseptic packaging machine is a very complex piece of machinery and considerable specialized know-how and resources would need to be invested to enter the market. Because of the maturity of the market and its inbuilt conservative nature (see above) a potential entrant faces considerable risk that the investment outlay will exceed returns. These factors can be expected to diminish the likelihood of entry in the near future.

To the Commission's knowledge, with the exception of Elopak/Shikoku, there are no manufacturers of aseptic carton packaging machines trading actively outside the Community that are likely to enter the Community market in the near future.

In the light of the above, the Commission considers that the unlikely occurrence of entry on the market means that in this respect Tetra Pak will not be constrained from acting to an appreciable extent independently of its competitors, customers, and ultimately of consumers.

3.5. Conclusion

The Commission concludes that Tetra Pak holds a dominant position on the market for aseptic carton packaging machines in the Community as a whole.

4. *No strengthening of an existing dominant position*

Tetra Pak holds a position of great market power. Thus the Commission has examined very carefully whether the operation will in any way strengthen that position. When faced with such a high degree of dominance, the Commission must be particularly vigilant, because in such circumstances even a very small increase in market power can have a disproportionately large negative effect on the competitive conditions on the market place.

In particular, the Commission has examined whether the operation would be likely to give to Tetra Pak certain marketing or other advantages over non-integrated aseptic carton packaging machine suppliers that would be likely to limit growth by existing competitors or raise barriers to entry for potential competitors. This is of particular concern in this case because the barriers to entry, both technical and commercial, into the market for aseptic carton packaging machines are already very high, and the creation of additional entry barriers, further foreclosing the market to potential competitors, would be of significant concern.

All of the detailed investigations undertaken by the Commission lead to the conclusion that in fact the creation of a full-line (processing and packaging machines) capability within a single undertaking will not in fact confer upon Tetra Pak an advantage of real significance that would be likely to further increase the difficulty of entry or penetration of actual or potential competitors. The underlying reason for this is that the two categories of machines are distinct and separate in both technical and commercial terms. The following factors explain the reasons for this conclusion :

— Only where processing and packaging machines are purchased simultaneously could the ability to offer both machines be potentially significant. The Community market for such processing lines is a mature one. According to figures available to the Commission less than 5 % of total packaging machine purchases have occurred simultaneously with processing machine purchases over the last three years. This inevitably reduces to almost insignificance any potential advantage available to Tetra Pak as a result of the concentration.

  Furthermore, when purchasers of aseptic carton packaging machines were asked to put in order of importance the factors relevant to which brand of aseptic carton packaging machine to purchase (price, reliability, speed etc.) invariably the ability to offer both packaging and processing machines within a single undertaking was considered the least important of the nine available choices. Even when asked to make a similar classification for circumstances in which both packaging and processing machines would be purchased simultaneously, the ability to offer both processing and packaging machines was once again considered to be the least important of the nine suggested factors.

— A number of large and strong actual and potential competitors are present on the markets for processing machines. Thus, if an actual or potential competitor of Tetra Pak perceived any advantages to flow from offering both packaging and processing machines, real and appropriate possibilities for doing so exist.

— It is also pertinent to note that none of the actual or known potential competitors of Tetra Pak in the aseptic carton packaging market considered that their expansion/entry prospects would be disadvantaged by the concentration.

— The interface between an aseptic packaging machine and an aseptic-processing machine is not complicated in technical/engineering terms. It is therefore a simple operation to change a Tetra Pak machine for that of another manufacturer and to ensure that it interfaces efficiently with an existing processing machine even if the processing machine is manufactured by Alfa-Laval. In this respect it is important to note that the technology in an aseptic processing machine is basic. There is therefore no real risk that Alfa-Laval aseptic processing machines could be made difficult to interface with other packaging machines than those of Tetra Pak.

— Dairies and juice processors are typically large undertakings with very significant buying power.

In the light of these factors the Commission concludes that the concentration will not reinforce Tetra Pak's existing dominant position in this market.

In arriving at this conclusion the Commission has not overlooked its Decision 88/501/EEC [1] 'Tetra Pak-BTG' of 26 July 1988, upheld by the Court of First Instance in its judgment of 10 July 1990, in Case T-51/89 [2]. In that case it found that Tetra Pak had abused its dominant position on the aseptic carton packaging market by acquiring a company holding a licence for a new packaging process and thereby preventing competitors from gaining access to this new technology. The Commission considers, however, that this merger does not in itself create a structure which would facilitate such abuses.

5. *Tetra Pak's activities in relation to non-aseptic machines and carton blanks*

5.1. In the market for non-aseptic carton packaging machines Tetra Pak has a very high market share, which is however lower than that in the market for aseptic carton packaging machines. The connection between a non-aseptic packaging machine and a processing line is even simpler than between an aseptic packaging machine and a processing line. Thus the reasons why the concentration will not reinforce Tetra Pak's dominant position in the aseptic market apply to an even greater extent in the non-aseptic market. In the light of this, the Commission considers that the operation will not create or strengthen a dominant position of Tetra Pak in the non-aseptic carton packaging market.

(1) OJ No L 272, 4. 10. 1988, p. 27.
(2) ECR 1990, p. II. 309.

5.2. The market for carton blanks constitutes a separate relevant product market for the purposes of the Commission's assessment of this case, and there are good reasons for concluding that Tetra Pak is dominant at least on the market for carton blanks for aseptic packaging machines. The existence of such a dominant position is a direct result of Tetra Pak's strength on the packaging machine market. At present Tetra Pak alone provides the carton blanks for the aseptic packaging machines that it has manufactured. It holds over 80 % of the general market for carton blanks for aseptic packaging machines. It thus benefits from an existing production, distribution and marketing infrastructure of a size unavailable to its competitors. Most of all, because of the overriding importance of sterility maintenance to purchasers, it benefits from a very considerable advantage when selling cartons for its machines ; due to the serious consequences of a sterility failure customers will always have a tendency to purchase cartons from the machine producer. It therefore follows that if the operation will not create or strengthen any dominant position on the market for the aseptic packaging machines, no strengthening of any dominant position on, the carton markets will result from the concentration.

C. Effects of the concentration on Alfa-Laval's operations

1. *The relevant product markets*

Alfa-Laval produces a wide range of processing equipment used in a number of industries. The concerns of the Commission in this case relate to the likely effects resulting from the vertical complementarity between Tetra Pak's aseptic packaging machines and those machines produced by Alfa-Laval which might precede a Tetra Pak machine in a processing line.

After having examined the milk processing machine sector, the Commission has identified a number of stages through which milk passes during its processing for aseptic packaging. Each stage involves machines which fall into a particular product category which cannot be substituted for a machine used in another category.

The stages and types of machines can be represented as follows :

— separator : removes fat from milk and cream,

— standardization equipment : ensures a standard fat content of milk and cream,

— plate heat exchanger : destroys the pathogenic bacteria dangerous to humans. The resultant product may then be packaged as pasteurised milk, with a non-aseptic packaging machine,

— aseptic processing unit : this unit destroys the microorganisms responsible for the rapid decay of milk. A UHT unit heats the milk to 140° and cools it very quickly. Such milk, if packaged aseptically, has a shelf-life of up to six months.

The Commission is aware that alternative classifications of the processing machines that make up a milk line might be put forward, and machines such as pumps, valves, storage tanks and control systems might be included. However, information in the Commission's possession indicates that Alfa-Laval's position in such markets is not appreciably different to that in the abovementioned ones, and the markets exhibit similar technical and marketing characteristics to those defined. In the light of this, the Commission considers that the inclusion or exclusion of the above products as additional relevant product markets affected by this transaction would not affect the analysis figuring below. For the purpose of the analysis of the notified concentration the Commission therefore considers that the relevant product markets for Alfa-Laval's milk processing machine activities are the machine categories mentioned above. For similar reasons, the classification is equally applicable for analysing the effects of the concentration in the juice processing sector.

2. *The geographic reference market*

Machines that are sold in the abovementioned categories are materially identical throughout the Community. Similar distribution systems are used by the companies for their machines throughout the Community. The Commission therefore concludes that the conditions of competition throughout the Community for the products in question are sufficiently homogeneous to assume that the geographic reference market for the purpose of examining the notification is the Community as a whole.

3. *Dominant position*

3.1. Market shares

According to the information available to the Commission, market shares for the product categories in question for 1990 were :

Separators : Westfalia [([1])] %, Alfa-Laval [...] %, others [...] %

Standardization equipment : Alfa-Laval [...] %, APV [...] %, others [...] %

([1]) In the published version of the Decision, some information has hereinafter been omitted, pursuant to the provisions of Article 17 (2) of Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets.

Heat exchangers: Alfa-Laval [...] %, APV [...] %, others [...] %

Aseptic processing systems: Alfa-laval [...] %, Finnah [...] %, APV [...] %, Stork [...] %, others [...] %

3.2. Size and importance of competitors

A number of large, important and effective competitors operate on all the relevant markets listed. Some of these competitors, in particular APV, are large companies with substantial resources. However, it should be noted that in relation to separators, standardization equipment and aseptic processing systems Alfa-Laval holds very large market shares.

3.3. Supply-side substitutability

3.3.1. From neighbouring markets

There is a very high degree of supply-side substitutability between supplies of separators, standardization equipment and plate heat exchangers for milk processing and supplies of similar equipment for other purposes, including brewing, food processing and pharmaceutical uses. The machines used in these different industries require little modification for use in the dairy sector. Most companies producing such machines have a high percentage of their relevant turnover outside the dairy/juice industry.

3.3.2. Potential market entrants

The technical knowledge necessary for the manufacture of separators, standardization equipment, plate heat exchangers and aseptic processing machines is not particularly difficult to acquire. Marketing/capital considerations, rather than technical/regulatory entry barriers are likely to be relevant in a decision by a potential entrant whether or not to enter any of the abovementioned markets.

4. *Conclusion*

In the light of the above it is concluded that in relation to the relevant product markets set out above, whilst Alfa-Laval holds a leading position in the relevant markets, it does not at present hold such a degree of market power that it is able to act to an appreciable extent independently of its competitors, customers, and ultimately of its consumers. Prior to the concentration, therefore, Alfa-Laval does not hold a dominant position which might be strenghtened by the present operation.

5. *No creation of a dominant position of Alfa-Laval*

The Commission has undertaken a widespread and detailed inquiry to determine whether the ability to offer both packaging and processing machines within a single undertaking will give the merged company such an advantage over its competitors for liquid food processing machines that it would, over a period of time, be expected to acquire a dominant position on any of the markets identified.

The results of this inquiry lead to the conclusion that in fact no such dominant position will be created. Many of the reasons why the ability to offer both processing and packaging machines will not confer upon Alfa-Laval such advantages over its competitors that a dominant position may be expected to develop are parallel to those explained above in relation to Tetra Pak's aseptic packaging operations. This is true, in particular in relation to the following factors:

— sales of full line installations (or 'turn-key' installations) represent less than 5 % of total sales for processing equipment,

— the technology used in packaging and processing machines are significantly different,

— the interface connection between packaging and processing machines is not complicated,

— dairies and juice processors have significant buying power.

Furthermore, due to the 'low tech' nature of processing machines, it is very easy to substitute a machine (whether it be a separator, standardization equipment, a plate heat exchanger or an aseptic processing unit) of one manufacturer for that of another. Most 'milk lines' are made up of machines of different suppliers and there is no real advantage in purchasing all the line from a single purchaser.

When purchasers of the four types of processing machine were asked to put in order of importance the factors relevant to the question of which brand of aseptic carton packaging machine to purchase (price, reliability, speed etc.) invariably the ability to offer both packaging and processing machines was considered the least important of the nine available choices. Even when asked to make a similar classification for circumstances in which both packaging and processing machines would be purchased simultaneously, the ability to offer both processing and packaging machines within a single undertaking was once again considered to be the least important of the nine suggested factors.

In the light of these factors, the Commission considers that the concentration will not create a dominant position in any of the markets for liquid food processing equipment identified above as a result of which effective competition would be significantly impeded in the common market.

V. **Conclusion**

The Commission concludes that the notified concentration is compatible with the common market within the meaning of Article 2 (2) of the Regulation.

HAS ADOPTED THIS DECISION:

Article 1

The notified concentration between Tetra Pak and Alfa-Laval is declared compatible with the common market.

Article 2

This Decision is addressed to:

Tetra Pak International SA,
70, avenue Général-Guisan,
PO Box 446,
CH-1009 Pully (Lausanne),
Switzerland,

and

Alfa-Laval AB,
PO Box 12150,
S-102 24 Stockholm,
Sweden.

Done at Brussels, 19 July 1991.

For the Commission
Leon BRITTAN
Vice-President

II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 31 July 1991

declaring the compatibility of a concentration with the common market

(Case No IV/M012 Varta/Bosch)

Council Regulation (EEC) No 4064/89

(Only the German text is authentic)

(91/595/EEC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings (1), and in particular Article 8 (2) thereof,

Having regard to the request of the German *Bundeskartellamt* of 18 March 1991 for referral of the case according to Article 9 (2) of the aforesaid Council Regulation,

Having regard to the Commission Decision of 12 April 1991 to initiate proceedings in this case,

Having given the undertakings concerned the opportunity to make known their views on the objections raised by the Commission,

Having regard to the opinion of the Advisory Committee on Concentrations (2),

(1) OJ No 395, 30. 12. 1989, p. 1, amended version : OJ No L 257, 21. 9. 1990, p. 13.
(2) OJ No C 302, 22. 11. 1991, p. 6.

Whereas :

I. CONCENTRATION

(1) The proposed concentration was notified on 25 February 1991. It concerns the creation of a new company, Starterbatterie GmbH, by Varta Batterie AG (Varta) and Robert Bosch GmbH (Bosch), to which the companies will transfer their starter battery business. Varta will acquire a 65 %, and Bosch a 35 % interest in the new company.

(2) The notified operation is a concentration within the meaning of Article 3 (1) (b) and (2) of Council Regulation (EEC) No 4064/89.

(3) Varta and Bosch will control the new company jointly. A specific agreement concluded by the parties *(Rahmenvertrag)* provides for participation of both parent companies in the management and supervisory board of the new company. In particular, both parties will have the right to appoint managing directors of the joint venture. A number of decisions directly related to the management of the new company will have to be taken by a 75 % majority. This applies, for example, to the approval of detailed budget plans for the joint venture and to the appointment and dismissal of the directors and members of the executive and supervisory boards of the subsidiaries of the new company, thus ensuring the influence of both parties in the management of Starterbatterie GmbH. Furthermore, Varta and Bosch will be equally represented on the supervisory board of the joint venture.

(4) The new company will perform on a lasting basis all the functions of an autonomous economic entity. Starterbatterie GmbH will carry on the development, production and distribution of starter batteries. It will be economically independent of its parent companies and will be responsible for its own commercial policy.

(5) Varta and Bosch will transfer all their national and international starter battery activities to the joint venture, including product-related R&D, production and distribution facilities, and will withdraw from such activities. Although Bosch will sell some starter batteries produced by the joint venture through its distribution network for other automotive parts, it will act as a commission agent only on the instructions and for the account of Starterbatterie GmbH. From an economic point of view, it cannot be considered likely that one of the companies will re-enter the market as an independent supplier. Varta will continue to produce other battery products (traction, stationary consumer batteries), whereas Bosch will continue its traditional activity as a producer of automotive parts. Nevertheless, the Commission does not have any indication that the creation of the joint venture will have anti-competitive effects on the abovementioned activities of the two companies. In this respect there is no risk of coordination of the competitive behaviour of the undertakings which remain independent.

II. COMMUNITY DIMENSION

(6) The proposed concentration has a Community dimension. Worldwide turnover (Varta : ECU 1 billion, Bosch : ECU 15 billion) and Community-wide turnover (Varta : ECU 0,7 billion Bosch : ECU 11 billion) of the parties for 1989 exceed Article 1 (2) of Regulation (EEC) No 4064/89 thresholds. Neither Varta nor Bosch achieve more than two-thirds of their Community turnover in one and the same Member State.

III. THE PARTIES

(7) Varta is the most important battery producer (starter batteries, industry batteries, consumer batteries) in Germany and one of the most important battery manufacturers in the Community. As far as starter batteries are concerned, the company is active in every Member State as a supplier to vehicle producers as well as to retailers.

(8) Bosch is *inter alia* a worldwide producer of automotive parts, including starter batteries; telecommunication equipment and consumer goods. Up to now, Bosch has offered starter batteries mainly to the replacement market, where it is well represented all over Europe. Bosch supplies the original equipment market for starter batteries mainly in Spain, through its Spanish subsidiary Femsa.

IV. DECISIONS TAKEN BY THE COMMISSION DURING THE PROCEEDINGS

1. The Decision to initiate proceedings

(9) After examination of the notification, the Commission concluded that the notified operation raised serious doubts as to its compatibility with the common market. It therefore decided on 12 April 1991 to initiate proceedings pursuant to Article 6 (1) (c) of Regulation (EEC) No 4064/89.

2. The Statement of Objections

(10) Following investigations carried out amongst a broad range of undertakings operating in the affected markets as competitors or customers, the Commission sent the parties, on 24 May 1991, a Statement of Objections in which it raised objections regarding the replacement market for starter batteries in Germany and Spain.

(11) The objections set out in the Statement of Objections may be summarized as follows:

(a) *Relevant product market*

(12) The starter battery sector has to be divided into two distinct product markets:

- the original equipment market, which comprises the supply of starter batteries for vehicle producers for the initial equipment of new vehicles;
- the replacement market, which comprises the supply of replacement batteries to the retail market for the equipment of used cars.

(13) In general terms the distinction between the two product markets is not mainly based on a difference in the product itself or on the function of the product. It resides mainly in the fact that the conditions of competition differ significantly on the two markets, as a consequence of which the producers have to adapt their commercial and entrepreneurial policies to the different requirements of the two sales markets.

(14) In general terms, the original equipment market is characterized by its specific demand side, the automobile industry, which gives the market specific features. In particular, supply to the original equipment market implies a steady demand of a reduced number of battery types [Bosch (<40), Varta (>100)] by a small number of clients. According to

the notification of the parties concerned Varta sold [...] % [1] and Bosch [...] % of their respective sales volume to five clients of the original equipment market. As to the nature of the product, batteries for the original equipment market have to correspond to the specifications required by the car manufacturers (Bosch, Varta, letter of 8 March 1991, page 4), they are supplied charged and on specific pallets (Bosch, letter of 30 October 1990, page 2). The quality and standard including zero-defect reliability of the products is prescribed and controlled by the car manufacturers. Supply to the original equipment market is generally linked to R&D cooperation for new products with the car manufacturers which enables the suppliers to follow the latest technical developments in the market. Distribution on the original equipment market means just-in-time delivery to a small number of clients.

(15) Supply to the replacement market, on the other hand, implies strong seasonal fluctuations in demand for a larger number of battery types (Bosch : > 200, Varta : < 300), with a variety of different distributors ranging from purchase organizations, wholesalers, car producers and department stores to ultimate dealers. As to the nature of the product, replacement batteries, even if sold to car manufacturers, are adapted to current standards so that the same type can be used in some cars of different producers (Varta, Bosch, letter of 8 March 1991, page 4). They are mainly delivered as dry batteries. The quality and standards are not controlled by the customers (Varta, Bosch, letter of 8 March 1991, page 5) nor is there any feedback or cooperation as to R&D for new products. Distribution to the sales markets requires the existence of a distribution and service network system because a number of clients require delivery to the local outlets and service.

(16) The distinction between the original equipment market and the replacement market is common practice in the industry (Bosch, letter of 30 October 1990, page 2). It has in general terms been confirmed by the Court of Justice for heavy goods vehicle tyres [see Court of Justice, Industrie Michelin v. Commission [2]]. The parties in the present case consider that such a differentiation cannot be justified but have nevertheless in practice made a clear distinction between the two markets. In the organization of their new joint venture they establish separate divisions for the original equipment and replacement market with different managing directors *(Rahmenvertrag* 3.1.).

(b) *Relevant geographical markets*

(17) The replacement markets for starter batteries in Germany and Spain are still considered as national markets. Investigation has shown sufficiently homogeneous conditions of competition in both countries, which differ appreciably from the conditions of competition in the other Member States, to establish separate geographic markets.

(18) Two factors indicate this :

— the market shares of the manufacturers are very different in each Member State,

— as shown by the information communicated by the parties and their competitors, the manufacturers are able to charge in Germany and Spain for the same types of batteries different prices to those which they charge in the other Member States.

(19) These differences, which continue to exist despite the absence of any specific legal barriers, may be attributed to a range of causes which taken as a whole establish appreciably different conditions of competition in the various Member States.

(i) Nature and characteristics of the product

(20) Different product ranges reflecting different requirements of the demand side are sold in the various Member States.

(21) Starter batteries are adapted to the specific electrical requirements of the different types of vehicles. Despite the fact that one type of replacement battery can be used for a number of different types of cars, more than 400 different types of replacement batteries are currently produced in the Community. Each type varies in relation to size, power, etc.

(22) The importance of sales of these different types varies in the respective Member States. The different stock of cars in the different Member States influences the battery types sold in the Member States. The four large producers, Varta, Bosch, CEAc and Magneti Marelli, having together more than 50 % of the market in Germany, Spain, France and Italy, were asked for their 10 most popular battery types (best sellers) in each of these Member States, where about 20 million batteries were sold in 1990. The results are the following :

[1] In the published version of the Decision, some information has hereinafter been omitted, pursuant to the provisions of Article 17 (2) of Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets.

[2] 1983 ECR. 3461.

— the total number of different battery types included in the 10 best sellers of the four suppliers in the four Member States mentioned above is 77,

— 59 of these types are among the best sellers in one Member State (volume : 2,3 million),

— 11 types are among the best sellers in two Member States (volume : 1 million),

— three types are among the best sellers in three Member States (volume : 0,5 million),

— four types are among the best sellers in all four Member States (volume : 2,3 million).

(23) Given the large variety in types offered in the Community, replacement batteries cannot be regarded as homogeneous products. Therefore the different product ranges sold in the various Member States constitute a structural difference in the conditions of competition.

(24) A change in this respect cannot be expected in the near future. This is particularly because the national product range of replacement batteries is related to the stock of vehicles in a country, the composition of which has not significantly changed in the last few years. Taking into account that the life-cycle of a battery of a new car is approximately five years, even a strong alignment in the stock of new vehicles would have only a very small effect on the replacement battery markets within the near future.

(ii) Buyer preferences

(25) The preferences of buyers for branded replacement starter batteries are evident in every Member State and they differ significantly in brands favoured.

(26) On the Italian market all large suppliers sell their batteries — with a few exceptions — under their own brand. In Spain and Germany the share of manufacturer brands is estimated at above 80 %. In France, the share of manufacturer brands has declined in the past as a result of the expansion of modern distribution systems. According to Fiat's estimates, it is currently about 60 % of the sales volume. Generally, shares in value terms are higher than shares in volume terms, because of the higher prices charged for manufacturer brands.

(27) The fact that suppliers use different brands in different Member States can be demonstrated by the information provided by Bosch and Varta. In Germany Bosch sells (a very substantial share) of its branded batteries under the 'Bosch' label whereas in France and Spain it sells (a very substantial share) and (a very substantial share) respectively under its 'FEMSA' label. In Spain and Germany Varta sells (a substantial share) and (a substantial share) respectively of its branded batteries under the 'Varta' label, whereas it sells in France (a substantial share) under its brand 'Baroclem' (Varta, Bosch, 8 March 1991, Annexes 1a and 1b).

(iii) Structure of the demand side

(28) An important element establishing different conditions of competition is the structure of the demand side. There are substantial differences in the spread and importance of the different distribution channels present in each Member State.

(29) This is confirmed by the notifying parties as well as by competitors and checked by an investigation. The results of this investigation show, for example :

— the share of the replacement batteries sold through the own distribution network of battery producers differs from more than 20 % in Member State [. . .] and in Member State [. . .] to less than 10 % in Member State [. . .] and in Member State [. . .];

— replacement batteries sold through the distribution channels of the vehicle producers, their dealers or importers account for about 20 % of the market in France and 15 % in Germany but less than 10 % in Spain and less than 5 % of the Italian market;

— the distribution channel of independent dealers of automotive parts is in every Member State the most important distribution channel but its share in the total replacement market differs from about 40 % in France to above 80 % in Italy. Also within this distribution channel the structure of the clients is very different. In Italy and Spain this distribution channel is characterized in particular by a large share of ultimate dealers, followed by wholesalers; in Germany and the United Kingdom it is dominated by wholesalers; and in France by purchasing organizations of wholesalers;

— department stores and supermarkets are significant only in France (above 20 % of the market) but not in Spain, Germany and Italy (less than 5 %);

— oil companies have a small share in the German and French market (about 5 %) but are of no relevance in Spain, Italy and the United Kingdom (less than 1 %).

(30) Although a tendency towards concentration on the demand side is to be expected, particularly in Germany and Spain where modern distribution systems are not yet very important, it cannot be considered that these developments will lead to radical change in the structure of the distribution systems in these Member States in the near future.

(iv) Supply side and barriers to entry

(31) The concentration of supply varies considerably from one Member State to another. The more supply is concentrated in one market, the more difficult it will be for actual or potential competitors to increase their market shares or to penetrate a market. Market-related barriers do still exist, which is confirmed by the fact that although there have been no legal or other trade barriers to entry for batteries within the European Community for years (apart from customs duty levied in Spain until 31 December 1992), significant market penetration in the five largest Member States in most cases only became possible through acquisition of a national company or of an existing plant. Tudor, after an unsuccessful attempt to enter the German market on its own, has acquired the German company Hagen.

(c) *Market dominance*

(32) The proposed concentration would give the new entity a dominant position in Germany and Spain, with the result that effective competition would be significantly impeded, because of the following factors :

The German market

The market share of the new entity would amount to 44,3 %.

The lead of the order of (>25 %) over the next largest competitors would be considerable.

The other competitors are small and medium-sized battery specialists.

Varta/Bosch has greater financial strength than the most important competitors.

The new entity has leading production capacity in comparison with its nearest competitors and furthermore the existing use of capacity by its nearest competitors is already high.

The other large European producers on the German market have only small market shares.

The Spanish market

The market share of the new entity would amount to 44,5 %.

The existence of an equally strong competitor, Tudor SA, could lead for several reasons to alignment of the behaviour of both competitors.

In particular the absence of other large actual competitors able to counter any alignment of the behaviour of the main competitors on the Spanish market is noted.

V. CHANGES AFTER SENDING THE STATEMENT OF OBJECTIONS

(33) Following the Statement of Objections an oral hearing of the parties was held. As a result the Commission maintained its objections as to the German market.

(34) Since the Statement of Objections was sent, the following factual changes have occurred :

- Fiat has acquired the French battery producer CEAc, which has a market share of between 2 and 5 % in Germany;
- the Fiat group has entered into an agreement to acquire via CEAc the German battery producer Sonnenschein. Sonnenschein has a market share of between 5 and 10 % in Germany,

and the following commitments have been entered into by Varta :

- Varta has informed the Commission that it will cut its cooperative links with the Deta/Mareg group of companies. It will, for this purpose, within an agreed period :
  - terminate its licence agreement with the Deta/Mareg group and will not prolong Deta/Mareg's right to use any of Varta's property rights. Any new licence agreements on starter batteries will only be concluded with the consent of the Commission,
  - end any overlapping between membership of the management and supervisory board of Varta on the one hand and of the Deta/Mareg group on the other hand.

VI. IMPLICATIONS OF FACTUAL CHANGES AND COMMITMENTS IN THE AFFECTED MARKETS

(35) The abovementioned concentration projects of Fiat (CEAc and Sonnenschein) and Varta's commitment constitute an important change in the market

structure and have an influence on the assessment of the concentration project Varta/Bosch as far as the creation of a dominant position is concerned. They do not however influence the Commission's overall assessment of the definition of the relevant product and the relevant geographic markets.

(36) The Advisory Committee on Concentrations expressed on 17 July 1991 the majority opinion that the factual changes were insufficient to alter the appraisal given in the Statement of Objections. The Commission has taken the utmost account of the Advisory Committee's opinion in drawing up this Decision.

1. **Relevant product market**

(37) As to the relevant product market, the parties have claimed that the original equipment sector and the replacement sector for starter batteries belong to the same product market. They have nevertheless confirmed, before the oral hearing, that technical and qualitative differences exist between the two markets, and they have organized the new joint venture by clearly separating the directorates dealing with the original equipment activities and those dealing with the replacement market activities. Given the reasons set out in the Statement of Objections and the fact that distinguishing between the original equipment market and the replacement market for starter batteries is common practice in the industry, the Commission maintains its original assessment.

2. **Relevant geographic market**

(38) The parties further stated that the relevant geographic market for replacement batteries is the European market. They object to the Commission's appraisal that different conditions of competition exist in different Member States. In particular they attack the following criteria put forward to establish the existence of these different conditions of competition :

(39) (a) As to the nature and characteristics of the product, the parties state that batteries are homogeneous products and that no different product ranges are offered in different Member States. Nevertheless, Varta has provided information about the 20 most popular battery types (best sellers) it sells in the five largest Member States (Germany, Spain, France, Italy, United Kingdom). Analysis of these shows that only a very small number of battery types are best sellers in more than one Member State. The results were the following :

— the total number of different battery types included amongst the 20 best sellers in the five Member States mentioned above is 77 ; these represent 69 % of the total volume of sales (volume : [...] million),

— 62 of these types are among the best sellers in one Member State (volume : [...] million),

— eight types are among the best sellers in two Member States (volume : [...] million),

— three types are among the best sellers in three Member States (volume : [...] million),

— two types are among the best sellers in four Member States (volume : [...] million),

— one type is among the best sellers in five Member States (volume : [...] million).

(40) Furthermore it cannot be expected, as the parties presume, that the differences in the product ranges existing in the different Member States will decrease to a significant extent, because in the last 20 years the percentage share of imported vehicles has increased. On the one hand, vehicle imports into the Member States can be very different. Approximately one third of imports into Germany are, for example, Japanese cars, which is not the case for France and Italy. On the other hand, it cannot be expected that a strong rapprochement of the different product ranges will take place in the near future.

(41) (b) With regard to the assessment of existing consumer preferences and in particular to the importance of brands in the German market, the estimates of the Commission (about 80 %) and the parties (78,8 %) correspond as to the share of the manufacturer's brand in the market. Furthermore the parties have declared that they sell (a very substantial share) % (Bosch) and about (a very substantial share) % (Varta, dual brands included) of their batteries under their own brands (Varta, Bosch, letter of 8 March 1991, Annexes 1a and 1b) in Germany.

(42) (c) As to the structure of the supply side, the parties claim that the Commission has not sufficiently taken into consideration the imports into the German and Spanish markets. For the German market the proportion of imports in value is estimated by the Commission to be about 15 %, by the parties to be 16,4 %, having increased since 1975 and been stagnant in the last years. This difference cannot be considered substantial enough to change the general assessment.

(43) (d) The parties further claimed that the Commission should have based its analysis on the import volume in units. With regard to the question whether the assessment has to be based on the imports measured in value or in volume, the Commission considers that, in particular in this case, only the figures in value are reliable. Firstly there is large uncertainty in the import quotas in terms of volume : the official import statistics are measured in weight not in units which makes further estimates necessary ; and they include group internal imports (e.g. Varta's group internal exchange of starter batteries within the Community amounts to [. . .] million batteries) and sales to competitors (more than [. . .] million batteries in the Community). Secondly, import figures in volume do not reflect the qualitative significance from a competitive point of view. Figures in volume do not weight the different types of batteries, e.g. batteries for motor cycles or trucks. Therefore it is considered as justified and necessary to base the assessment on imports in value as they reflect the evaluation of the market for the product concerned and take into account all other elements influencing competition.

3. Market dominance

(44) The abovementioned factual changes have, in contrast, an impact on the legal assessment as to whether the concentration would create a dominant position for the new entity on the German market.

(a) *Acquisitions by Fiat*

(45) Fiat/Magneti Marelli's acquisition of CEAc and Sonnenschein would change the structural market conditions in several respects.

(46) Due to the acquisitions of CEAc and Sonnenschein, Fiat's market share in Germany will increase from 1 % to more than 10 %.

(47) More important than the pure increase of market share is the substantial material change of the competitive potential that accompanies this increase.

(48) Before the two acquisitions, Fiat/Magneti Marelli's, as well as CEAc's, market potential in Germany was largely restricted although both companies had financial strength and, with regard to Fiat, also spare capacity. The reason for this restricted market potential was that Fiat and CEAc did not have a physical presence in the German market. In particular they did not have well-known German brands and they had at their disposal only a marginal distribution network. Fiat and CEAc therefore had to be considered in Germany as a kind of niche supplier, e.g. for wholesalers specialized in the distribution of French or Italian automotive parts. In this respect they could not be regarded as a real alternative to the other suppliers in the market, such as Varta, Bosch, Deta/Mareg, Hoppecke, Tudor/Hagen or Sonnenschein, offering well-known brands and having distribution networks.

(49) Before the acquisition, Sonnenschein's market potential was even weaker than indicated by its market share because it faced considerable financial difficulties and was confronted with ecological problems. It had planned to reduce its production capacity despite an existing full capacity use.

(50) The concentration of Fiat, CEAc and Sonnenschein will create substantial synergy effects which give rise to the expectation that the competitive potential of the new entity will be more important than the current market shares achieved through the merger might indicate. In particular, Fiat will be able to compensate its competitive shortcomings. It will have access to a well-known German brand and to all distribution channels. By that improved market access, Fiat's financial strength and its spare capacity will be able to have, for the first time, an impact on the German market. Due to the merger of Fiat/CEAc/Sonnenschein, a strong competitor will emerge whose competitive potential will be significantly larger than the sum of the separate potential of each of the companies before the merger.

(b) *Ending the cooperation with Deta/Mareg*

(51) Ending the cooperation between Varta and Deta/Mareg will influence the competitive relationship between the two groups in the sense that Deta/Mareg will be able to become an independent operator on the German market, and to enter into effective competition with the new entity Varta/Bosch.

(52) Before 1977 Deta/Mareg belonged, like Varta, to the Herbert Quandt group of companies. This group was then split up, as a result of which Varta and Deta/Mareg were separated and are now controlled by different members of the Quandt family. According to the information available to the Commission, the two new groups are not linked by cross-shareholding or by any other means that would establish any legal relationship between them.

(53) Nevertheless, there are two factual elements which can be considered as influencing the competitive relationship between the two groups of companies. Firstly, there is an overlapping membership between the supervisory boards of the two groups. Secondly, Varta and Deta/Mareg have concluded an automatically renewable licence agreement, the complexity of which far exceeds licence agreements that commonly exist between different producers in this industry. The agreement does not,

as can usually be found, refer to a specific technical application or area, but comprises a commitment to cooperation on a full scale ranging from mutual exchange of know-how on the production process, product development, respective use of patents and other intellectual property rights, exchange of R&D, to technical support in the form of exchange of experts for the respective production facilities. The agreement itself states the influence that Varta possesses in Deta and Mareg.

(54) Because of this comprehensive technical cooperation and the personal links on the supervisory boards, a relationship of mutual consideration has been and could be maintained which excludes effective competition between the two companies in the sales markets.

(55) The dissolution of this comprehensive agreement between Varta and Deta/Mareg is considered to break up the cooperative relationship between the two groups. It leads the way for Deta/Mareg to become an independent producer in the market.

(56) Given the complexity of the licence agreement it is considered that this factual change cannot be achieved by immediate dissolution, but has to take into account a certain transitional period during which the companies involved can adapt themselves to the future termination of their cooperation. In this respect the envisaged dissolution would have an immediate effect on the strategies and the competition concept of the companies.

(c) *Impact on competition*

(57) Both factual changes, the increase of the market potential of Fiat in the German market as well as the dissolution of the cooperative relationship between Varta and Deta/Mareg, give rise to the expectation that after the merger Varta/Bosch will not have an appreciable scope of action uncontrolled by its competitors.

(58) In the Statement of Objections, the creation of a possible dominant position of the new entity in the German market was concluded on the basis of an overall appraisal of a number of structural market criteria which primarily favoured the strong market position of the companies. In addition to the market share of 44 % and the lead of about (25 %) over the next competitor, particular account was taken of the fact that the next competitors for the new entity in terms of market share were small and medium-sized companies with far less financial strength and smaller production capacity. Furthermore, the strongest of the these competitors, Deta/Mareg with a market share of over 10 %, was not considered to be an independent competitor in relation to Varta/Bosch because of its comprehensive cooperative links with Varta. It was also taken into account that the big European competitors Fiat and CEAc, being only marginally represented in Germany, could not be expected to gain importance because of their lack of physical presence in the German market. These structural conditions will be different after the factual changes come into force.

(59) Although the market share of Varta/Bosch as well as the lead over the next competitor will remain high, the new entity will face in the future a different competitive environment in two respects.

(60) Fiat will not only be Varta/Bosch's second-strongest competitor in terms of market shares (more than 10 %), but above all it will have in future a number of competition parameters which were in the past only accessible to the national producers like Varta, Bosch, Hoppecke, Deta/Mareg, Tudor/Hagen : Fiat will be able to offer a well-established German brand in a downstream market, which is still significantly characterized by brand preferences. Fiat will through the Sonnenschein network have a physical presence in the German market and thereby be able to react in a rapid and flexible way to clients' demands. It can enlarge its access to the sales market by taking advantage of Sonnenschein's traditional supply relationships. Consequently, the possible scope for action by Fiat in the market is significantly opened in the sense that it will allow competitive moves into all other segments of the market.

(61) This improved access through Sonnenschein into the market will now give Fiat/CEAc the choice to use to a significant extent its financial strength and spare capacity also in the German market, which it could not do before because of its restricted clientele.

(62) Previously, the high combined market share of Varta/Bosch together with the above structural factors supported a possible creation of a dominant market position. However, through the factual changes these structural factors now favour its second most important competitor. As a result it is now at least doubtful if a market share of 44 % and the current lead over the next competitor is sufficient to prove a dominant position.

(63) Furthermore, Deta/Mareg will become an independent player in the near future in the German market. Given the complexity of the licence agreement described above, the termination of the cooperation and the overlapping membership in the supervisory board is considered to be significant. The fact that the links will be terminated only

after a certain period of time does not contradict this appraisal. It will enable the Deta/Mareg group to adapt its commercial strategy to the new situation and thus foster its development as an independent player or as a cooperative partner for a new competitor in the market. Furthermore it has to be expected that the dissolution process will start already in the near future following the need to adapt to the post-cooperation period. This might be accelerated by the specific dynamics which can be expected through the integration of the new five Länder into the German economy.

4. Conclusion

(64) Under these conditions the Commission deems the concentration of Varta/Bosch compatible with the common market,

HAS ADOPTED THIS DECISION:

Article 1

The proposed concentration notified by Varta Batterie AG and Robert Bosch GmbH is hereby declared compatible with the common market, subject to the obligations set out in Article 2.

Article 2

In order to ensure independence between Deta/Mareg and Varta/Bosch the following obligations are attached to this Decision:

(a) Varta will terminate the licence agreement with Deta/Mareg at the earliest possible termination date. The agreement provides for termination on 31 December 1993. With the coming into effect of the termination, any right to use intellectual property rights will also terminate.

Any new licence agreements on starter batteries shall be concluded only with the consent of the Commission;

(b) Varta shall ensure that there will be no overlapping membership of the boards (supervisory, management board) of Varta and Deta/Mareg. This obligation will come into force with the next appointment of the Varta supervisory board in the summer of 1993;

(c) For the purpose of this Article,

(i) Varta means Varta AG, Varta Batterie AG and any company controlled by any part of the Varta Group;

(ii) Deta/Mareg means Delton AG, CEAG Industrie-Aktien und Anlagen AG, Deta Akkumulatorenwerke GmbH, Mareg Akkumulatoren GmbH and any company controlled by the Delton/CEAG/Deta/Mareg group of companies.

Article 3

This Decision is addressed to:

Varta Batterie AG,
Am Leineufer 51,
D-3000 Hannover 21,

and

Robert Bosch GmbH,
D-7000 Stuttgart 10.

Done at Brussels, 31 July 1991.

For the Commission
Leon BRITTAN
Vice-President

OPINION

of the Advisory Committee on Concentrations given at the seventh meeting on 17 July 1991 concerning a preliminary draft decision relating to Case IV/M.012 — Varta/Bosch (1)

(91/C 302/07)

1. A majority of the members of the Advisory Committee considers that there is not a sufficient structural change in the German market, as a consequence of the acquisition of Sonnenschein by Fiat and the cutting of the links Deta/Mareg and Varta, that can attenuate the dominant position of Varta and Bosch, within the meaning of Article 2 of Council Regulation (EEC) No 4064/89.

2. The majority of the Committee considers that the changes that have taken place in the Spanish market as a consequence of the acquisition of Sonnenschein by Fiat are not significant.

3. For the above reasons, the majority of the Committee considers that there are no substantial changes in the German and Spanish markets with respect to the situation created by the establishment of the joint venture by Varta and Bosch and therefore disagrees with the compatibility proposal presented by the Commission in its draft decision.

4. A minority considers, on the contrary, that the acquisition by Fiat of Sonnenschein negates, on essential points, the motives that had led the Commission to open proceedings and makes it possible to presume the existence of a European market of starter batteries.

5. The Committee recommends the publication of this opinion.

(1) OJ No L 320, 22. 11. 1991.

II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 2 October 1991

declaring the incompatibility with the common market of a concentration

(Case No IV/M.053 — Aerospatiale-Alenia/de Havilland)

Council Regulation (EEC) No 4064/89

(Only the English, French and Italian texts are authentic)

(91/619/EEC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings [1], and in particular Article 8 (3) thereof,

Having regard to the Commission Decision of 12 June 1991 to initiate proceedings in this case,

Having given the undertakings concerned the opportunity to make known their views on the objections raised by the Commission,

Having regard to the opinion of the Advisory Committee on Concentrations [2],

Whereas :

I. BACKGROUND

The nature of the proceedings

(1) These proceedings concern a proposed operation which was notified on 13 May 1991 pursuant to Article 4 of Council Regulation (EEC) No 4064/89 (the 'Merger Regulation') consisting of the joint acquisition by Aerospatiale SNI (Aerospatiale) and Alenia-Aeritalia e Selenia SpA (Alenia) of the assets of the de Havilland division (de Havilland) from Boeing Company (Boeing).

(2) On 4 June 1991 the Commission decided to continue the suspension of the concentration pursuant to Article 7 (2) of the Merger Regulation, and on 12 June 1991 the Commission initiated proceedings in this case pursuant to Article 6 (1) (c) of this Regulation.

The parties

(3) Aerospatiale is a French company active in the aerospace industries. Its product range includes civil and military aircraft and helicopters, missiles, satellites, space systems and avionics. Alenia is an Italian company predominantly active also in the aerospace industries. Its product range includes civil and military aircraft, satellites, space systems, avionics, and air and maritime traffic control systems. Aerospatiale and Alenia jointly control the

[1] OJ No L 395, 30. 12. 1989, p. 1, amended version : OJ No L 257, 21. 9. 1990, p. 13.
[2] OJ No C 314, 5. 12. 1991, p. 7.

Groupement d'Intérêt Économique (GIE) Avions de Transport Régional (ATR) which was set up in 1982 in order jointly to design, develop, manufacture and sell regional transport aircraft. There are currently two ATR regional turbo-prop aircraft on the market.

(4) De Havilland, which is a Canadian division of Boeing, only manufactures regional turbo-prop aircraft. The former de Havilland Corporation (DHC) was nationalized by the Canadian Government in 1982 and sold to Boeing in 1986. There are currently two de Havilland regional turbo-prop aircraft on the market.

II. THE CONCENTRATION

(5) The notified operation is a concentration in the form of a concentration joint venture within the meaning of Article 3 of the Merger Regulation since:

— de Havilland will be run by an operating company which will be jointly controlled by Aerospatiale and Alenia, and

— the activities of Aerospatiale and Alenia in regional turbo-prop aircraft (commuters) have already been concentrated in the GIE ATR since 1982.

III. COMMUNITY DIMENSION

(6) The combined aggregate worldwide turnover of Aerospatiale, Alenia and de Havilland exceeds ECU 5 billion (Aerospatiale: ECU 4,7 billion; the Finmeccanica group, to which Alenia belongs: ECU 5,2 billion; de Havilland: ECU 0,5 billion). Aerospatiale and Alenia each achieve a Community-wide turnover of more than ECU 250 million. Furthermore, the undertakings concerned do not achieve more than two-thirds of their Community-wide turnover within one and the same Member State. Thus the concentration has a Community dimension within the meaning of Article 1 (2) of the Merger Regulation.

IV. ASSESSMENT PURSUANT TO ARTICLE 2 OF THE MERGER REGULATION

(7) The operation has as its effect that Aerospatiale and Alenia, which control the world and European leading manufacturer of regional aircraft (ATR), acquire the world and European number two (de Havilland) as explained below. Regional aircraft (commuters) are aircraft in a range of between 20 and 70 seats intended for regional carriers and have an average flight duration of approximately one hour. The regional transport market is mainly characterized by low density traffic where turbo-prop engined aircraft are, as a general rule, less expensive to operate than jet aircraft. Although the market has for the time being and will have until the mid-90s a relatively high growth rate, the commuter market is comparatively small in terms of aerospace markets generally (total worldwide value of deliveries of new commuter aircraft in 1990: US $ 2,3 billion, which is estimated at less than 2 % of the value of the total aerospace industry).

1. Relevant product markets

(8) The relevant product markets affected by the proposed concentration are those of regional turbo-prop aircraft.

Regional jet aircraft currently being developed (Canadair's 50-seat CL601 RJ jet) cannot be included in these markets. The commuter manufacturers and the airlines questioned on this issue have stated almost unanimously that it is unlikely that regional jet aircraft will compete with traditional turbo-props of a similar capacity. Regional jet aircraft have significantly higher acquisition and operating costs, and furthermore the time saving which a regional jet would offer compared to turbo-props is not significant until routes of 400 to 500 nautical miles are involved. The average distance operated by turbo-props is less than half of this, and according to the parties' own figures as many as 85 % of all regional transport aircraft flights are in fact below 400 nautical miles. It is considered therefore that there is no significant overlap of turbo-props and regional jets.

Jet aircraft of around 100 seats developed for short- and medium-haul flights (in particular the Boeing 737, the Fokker 100 and the British Aerospace BAe 146) are also not in competition with regional turbo-prop aircraft. These jet aircraft cost around twice as much as the largest turbo-prop aircraft, and are used on longer routes or routes with high density. The Commission has therefore followed the market definition of the parties, and all the competitors and customers contacted, by excluding jet aircraft from the relevant product markets.

(9) The parties exclude turbo-prop aircraft of below 20 seats from the overall commuter market. This is generally accepted by the industry and by the customers. Aircraft below 20 seats are subject to different type certification standards from the 20 to 70-seat aircraft. For aircraft of 19 seats and below, the certification security requirements such as crash-worthiness, systems reliability, fatigue resistance, damage tolerance, heat release of cabin materials in case of fire, etc., are much more lenient. These aircraft are physically smaller to the extent that the level of comfort is not comparable (for example, most do not provide toilet facilities, many are unpressurized, and normally passengers cannot stand up in the aircraft). Most of these aircraft are not developed specifically for commercial passenger transport, but are derived from general aviation aircraft. All documentation obtained in the Commission's enquiry regarding forecasts of the development of the overall commuter market, manufacturers' marketing comparisons, and strategic planning analyses deal only with commuters within the range of 20 to 70 seats.

(10) The parties in the notification, the customers and the competitors in their replies to the Commission's enquiry all identified distinct markets within the overall commuter market of 20 to 70-seat aircraft. The division into different relevant markets within the overall market is considered correct by the Commission.

A relevant product market comprises in particular all those products which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use.

It would not appear, for example, that a 60-seat commuter is interchangeable or substitutable with a 30-seat commuter. They are used on routes with a significantly different density. The prices vary significantly, [. . .] (1).

(11) According to the Commission's analysis three relevant product markets exist. The segmentation which realistically reflects the different conditions of competition in the overall market distinguishes between commuters with 20 to 39 seats, 40 to 59 seats and 60 seats and over.

(12) In terms of the types in current production or in development this would show direct competition as follows :

20 to 39 seats		40 to 59 seats		60 seats and over	
British Aerospace J41	(27 seats)	Casa CN235	(44 seats)	British Aerospace ATP	(64 seats)
Embraer 120	(30 seats)	ATR 42	(48 seats)	ATR 72	(66 seats)
Dornier Do 328	(30 seats)	de Havilland Dash 8-300	(50 seats)		
Saab 340	(33 seats)	Fokker 50	(50 seats)		
de Havilland Dash 8-100	(36 seats)	Saab 2000	(50 seats)		

(13) This analysis is based in particular on the following :

— The segmentation above is generally consistent with the views of the overwhelming majority of customers and competitors who replied to the Commission's enquiries. 86 % of these customers considered that the segment of 20 to 39 seats formed a separate relevant product market. 68 % of customers considered that above this segment there was a further break as defined above. The other customers (14 %) proposed that the overall market of 20 to 70 seats be divided into at least two relevant product markets, although not broken in the same way as suggested by the majority.

As to the competitors of ATR and de Havilland, the segment of 20 to 39 seats was also identified as a separate relevant product market by Saab, Embraer, Fokker, British Aerospace and Dornier. Saab, Fokker and Embraer further distinguished the aircraft competing in the middle segment of 40 to 59 seats and those competing in the segment 60 seats and above as competing in separate relevant products markets. Only Casa identified the relevant product markets in a significantly different way, proposing three segments of 15 to 30 seats, 31 to 49 seats and 50 to 70 seats.

— The table at point (12) shows that there are distinct clusters of aircraft around 30 seats, 50

(1) Within a range of between US $ 6 million and US $ 13 million.
In the published version of the Decision, some information has hereinafter been omitted, pursuant to the provisions of Article 17 (2) of Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets.

seats and 65 seats. It is generally accepted within the industry concerned and amongst customers that the different aircraft types in these clusters compete directly against one another. For the ATR 42, for example, the strongest competition is from the de Havilland Dash 8-300 and the Fokker 50. For the de Havilland Dash 8-100, for example, the strongest competition is from the Saab 340 and the Embraer 120. The segmentation therefore shows the groups of aircraft which are usually evaluated against each other by airlines.

— This segmentation is plausible given that it shows that ATR, de Havilland, Saab and British Aerospace have developed types which compete in a different segment to their original type. It cannot be expected that a commuter manufacturer would develop a new type to compete directly in normal circumstances with another type of its existing product range. Alternative segmentations which would suggest that the two de Havilland types, for example, would directly compete are not considered realistic.

(14) As to possible supply-side substitutability between segments, there may be some possibility in the medium term for the commuter manufacturers to modify existing types (to 'stretch'), so as to develop a new competing product in a higher segment, e.g. ATR 42 to ATR 72. This does not affect the analysis that a type in one segment would not be substitutable for a type in another segment. Furthermore, according to a study carried out for the parties, it would take considerable time, longer than three or four years, for manufacturers for example of 30-seat aircraft to switch their facilities to produce 50-seat aircraft, to the extent that these facilities already exist.

(15) The parties do not agree with the Commission's definition of relevant product markets. In the notification the parties propose that the overall market is divided into two distinct segments, one of 20 to 50 seats and one of 51 to 70 seats. This segmentation is said to be based mainly on the fact that under the regulations of the major countries a second air hostess is mandatory above 50 seats, and that this change significantly increases the operating costs of the carriers. This proposed segmentation is not however internally consistent. The segments are defined as 20 to 50 seats and 51 seats and over. In the larger segment, the analysis of the parties includes the 50-seater Dash 8-300, Fokker 50 and Saab 2000 types. According to such an analysis the ATR 42 with 48 seats is in another relevant product market to these three 50-seater types. This does not reflect the market reality since the ATR 42 is considered by competitors and customers to be the main direct competitor of these 50-seaters.

(16) Following the Commission's decision to open proceedings, the parties modified their initial proposal, and suggested that the total market (20 to 70 seats) should be taken as the relevant product market since segmentation is considered to be arbitrary at least to a certain extent. The results of the Commission's enquiry show, however, that there is a broad consensus amongst competitors and customers as to the relevant product markets described above. This does not sustain the parties' contention that the segmentation is arbitrary, or the contention that the markets should be aggregated.

(17) The parties contend that the number of seats is not the only factor taken into account by airlines in their decisions as to which aircraft to acquire. Other factors such as technical characteristics and direct operating costs are also cited as relevant. On this basis, aircraft in different size segments are said to compete directly.

The Commission considers that the parties draw an incorrect conclusion from the fact that customers take into account several factors in making their decisions as to which aircraft to acquire :

— when airlines are considering acquiring new aircraft the first stage in their analysis is to identify the characteristics of the routes which the aircraft will service. Route characteristics comprise in particular the expected passenger traffic and the frequency of flights. The analysis must take into account the level of business travel and the number of slots. Traffic and frequency define the ideal number of seats for the routes in question. The principal factor dictating an airline's fleet requirement is thus the approximate number of seats required to suit its route network ;

— once the basic approximate capacity requirement is defined, then the airline will choose between aircraft which are in the required capacity range. The choice will usually be amongst the aircraft grouped together in the relevant product markets defined above. This is shown by the replies of the customers, and the clustering of aircraft types. Having defined the basic capacity requirement, other factors such as price, direct operating costs, technical characteristics and level of comfort, for example, are evaluated. These factors will determine which aircraft of those being considered wins the order;

— the replies of customers to the Commission's enquiry bear out this general analysis. Factors other than seat capacity do not therefore define the relevant product markets, but determine only which is the most suitable aircraft within a given relevant product market.

(18) The parties claim that in eight cases (over an unspecified period) competition existed between two aircraft belonging to different (but adjacent) relevant product markets as defined above for specific orders. These very limited exceptions in themselves are not considered to disprove the general analysis for the reasons outlined below.

In exceptional circumstances a customer may choose between aircraft of significantly different capacities. One hypothetical example would be as follows, based on data provided by the parties. For routes of low density, for example an average of 30 passengers but with higher peak numbers, an airline might consider acquiring an ATR 42 with a capacity of 48 seats against an Embraer 120 with a capacity of 30 seats. The break-even point in terms of number of passengers for an average flight (150 nautical miles) is [...] (1).

Against this, however, by acquiring the ATR 42, the airline can meet higher demand at peak times should it materialize. There may be some low-density routes therefore where a larger plane may be considered by the airline as competitive with a smaller plane. However, for higher density routes, small aircraft are not substitutable for larger aircraft.

(1) Break-even point comparison.

Between the segments as identified therefore, there may be some substitutability of smaller planes by larger planes, but there would appear to be no similar substitutability of larger planes by small planes.

The parties have submitted three examples of what is claimed to be substitution by airlines of larger aircraft by smaller aircraft, two of these being United States airlines, the other a Scandinavian airline. These examples in fact only show that these airlines did not choose aircraft of exactly the same capacity in replacing very old aircraft of a former generation. This is hardly surprising since route characteristics would not be expected to remain fixed over time. However, as ATR's own study (2) of market potential states as a general conclusion, replacement of a given aircraft within a capacity class will be ensured either by aircraft with a similar capacity or by aircraft belonging to a higher seat class category.

(19) The parties claim that small aircraft may be substitutable for larger aircraft since carriers could make more frequent flights. This is not considered to be realistic as the following example demonstrates.

The theoretical substitution of a 33-seat Saab 340 for a 66-seat ATR 72, for example, would imply that the airline would make twice as many flights with the Saab 340 to carry the same number of passengers on a given route. This would only be feasible if the direct operating costs of the Saab 340 were 50 % or less of those of the ATR 72 (3). According to the parties' figures, however, the direct operating costs of the Saab 340 are [...] of those of the ATR 72. This means that a hypothetical airline substituting two flights of the Saab 340 for one flight of the ATR 72 would incur costs which were [...] higher (4). This would not be economically reasonable in particular since airlines operate on very low profit margins and this would lead to substantial losses.

(2) Aerospatiale, Strategic Planning Division, 1990-2009, Regional Transport Market Forecast.

(3) The direct operating costs of an average flight include depreciation, insurance, fuel, cockpit crew, cabin crew, maintenance, and landing fees.

(4) If the costs of one ATR 72 flight are taken as 100, the costs of two Saab 340 flights would be [...].

Furthermore, the ability to make twice as many flights would depend on twice as many slots being available for the airline. This is not realistic given the general scarcity of slots, in particular in the Community, especially in the main airports. Even if double the slots were to be made available it is doubtful whether the additional slots would be at suitable times. This is particularly important for routes with business traffic.

2. Geographical reference market

(20) The commuter markets from an economic point of view are considered to be world markets. There are no tangible barriers to the importation of these aircraft into the Community and there are negligible costs of transportation.

There is a significant mutual penetration in particular between the markets of North America and Europe. European commuter manufacturers compete successfully in North America, and the one North American competitor, de Havilland, has a strong market position within the Community. ATR, for example, has sold 39 % of its ATR 42 aircraft in North Amercia, and de Havilland has sold 58 % of its Dash 8-300 aircraft in Europe. The most significant region in the rest of the world is the Asia-Pacific region. Most of the commuter manufacturers are present in this region, and in particular Casa, Fokker, ATR and de Havilland.

In their analyses, the parties exclude China and the eastern European countries from the overall world market. This would appear correct since there is no interpenetration between the markets of China and the eastern European countries and the overall world markets, and it is not expected that there will be such interpenetration in the foreseeable future. Generally speaking, some of these countries, in particular the Soviet Union and China, have their own aircraft industries which fulfil the domestic demand. The aircraft produced to not meet the certification standards required by airlines in the rest of the world. Similary, the aircraft produced by the western manufacturers are too highly specified and usually too expensive for the airlines in China and eastern Europe. Although in the long term it cannot be excluded that significant demand may emerge from eastern Europe for such products, this depends however on the general economic development of these countries.

It is considered therefore that the geographical market to be taken into account is the world market excluding China and eastern Europe.

3. Market structure

(21) In the notification it is proposed that market shares should be calculated on the basis of firm orders to date (which includes all deliveries to date and orders placed but not yet delivered) for each commuter type which is currently manufactured or developed. This is the broad method of market share calculation used in the aircraft industry since it is considered to reflect the competitive position of the manufacturers of the aircraft on the market in terms of their industrial strength. This cumulation of sales smooths out distortions in annual figures which may result from an uneven pattern of orders and deliveries in a low-volume market [1].

(22) These market share figures do not take into account the existing stock of all turbo-prop aircraft still flying (ATR plus de Havilland account for around 25 %). This existing stock includes aircraft that are no longer produced and sold, as well as aircraft sold by competitors no longer on the market such as Shorts. These aircraft were based on completely different technology. There is a distinct break between the current generation of commuter aircraft (the new technology commuters) and the old aircraft which are no longer produced. The old aircraft such as the Fokker F27 and the British Aerospace HS 748 were developped in the late 1950s or the early 1960s. From an economic and technical point of view they were already obsolete by the early 1980s. Aircraft developed from the early 1980s were based on a new generation of engines and airframes adapted to these engines to meet the requirements of airlines at this time. This new generation of commuter aircraft was designed in particular to be much more fuel efficient following the rise in oil prices in the 1970s, and to achieve higher standards of performance and passenger comfort. All of the commuter types now in production or development belong to this new technology generation of aircraft.

Although there may be some residual marketing advantage for manufacturers now on the market with new technology aircraft arising from their

[1] Total orders as at 31 August 91 have been analysed in the enquiry. The Commission obtained from all the manufacturers full details of numbers of orders, deliveries and options. These figures have been used in the market share calculations. They vary slightly from the estimates supplied by the parties.

links with airlines still flying their old aircraft (further discussed at points (36) and (39)), this is not relevant for the calculation of market shares. It is meaningless to analyse market shares for the former generation of products in assessing the market power of the manufacturers now and in the future. The market share analysis must therefore be based only on orders and deliveries of new technology aircraft currently on the market. This is not disputed by the parties.

(23) On the relevant product markets, the world and Community market shares calculated on the basis of firm orders by units are accordingly as follows ([1]) :

(in %)

20 to 39 seats				40 to 59 seats						60 seats and over			
World		EEC		World			EEC			World		EEC	
Saab	34	Embraer	41	ATR	45	64	ATR	51	72	ATR	76	ATR	74
				+			+						
Embraer	31	Saab	31	DHC	19		DHC	21		BAe	24	BAe	26
DHC ([1])	25	DHC	21	Fokker		22	Fokker		22				
Dornier	8	BAe	6	Saab		7	Casa		6				
BAe ([2])	2	Dornier	1	Casa		7	Saab		0				

([1]) DHC = de Havilland.

([2]) BAe = British Aerospace.

(24) Following the Commission's decision to open proceedings, the parties submit that options should also be taken into account in calculating the market shares. It is considered however that options are not a sufficiently reliable indicator of the market strength of a manufacturer since they can be and are easily cancelled. According to the experience of ATR for its programme, on average [. . .] of options taken out for an aircraft which is already on the market and has proved its reliability are converted into firm orders. Only some [. . .] of options taken out for an aircraft not yet in service are however likely to be converted. Options for aircraft not yet in service may be placed by airlines only as an insurance to preserve the possibility of actually ordering the aircraft at a later stage should it prove successful. Although the conversion rate of options into orders can be measured historically, it is difficult to predict the future conversion rate for aircraft not yet in service at the present time, since this will depend on factors such as technical performance. This is in particular true for the options currently taken out for the Saab 2000. This aircraft, which is still in the stage of development, is designed to meet a possible need of customers for turbo-prop aircraft to fly longer distances than the normal commuter routes. According to the parties and the competitors, it is not at all clear whether this is a significant customer requirement, and it is thus contested within the industry whether the Saab 2000 will in fact achieve significant orders on its completion. If options were nonetheless to be taken into account in calculating the market shares, based on the conversion rates experienced in the past for the successful ATR programme, the market shares would be as follows based on orders plus options :

([1]) The market shares for all aircraft of over 40 seats which is considered to be one market rather than two by a minority of respondents to the Commission's enquiry are as follows :

(in percent)

40 seats and over					
World			EEC		
ATR	51	66	ATR	57	72
+			+		
DHC ([1])	15		DHC	15	
Fokker		17	Fokker		16
Saab		6	BAe		7
Casa		6	Casa		5
BAe ([2])		5	Saab		0

([1]) DHC = de Havilland.

([2]) BAe = British Aerospace.

(in percent)

20 to 39 seats				40 to 59 seats						60 seats and over			
World		EEC		World			EEC			World		EEC	
Embraer	36	Embraer	44	ATR	42	59	ATR	50	71	ATR	82	ATR	79
				+			+						
Saab	31	Saab	29	DHC	17		DHC	21		BAe	18	BAe	21
DHC ([1])	20	DHC	21	Fokker	19		Fokker	22					
Dornier	9	BAe	5	Saab	16		Casa	6					
BAe ([2])	4	Dornier	1	Casa	6		Saab	1					

([1]) DHC = de Havilland.
([2]) BAe = British Aerospace.

(25) In order to obtain an overall view of the impact on the entire commuter industry, the three relevant product markets as defined have been aggregated. It is considered necessary for this purpose to take into account the different sizes of the various types. The number of firm orders has therefore been multiplied by the standard number of seats for each type. This is so as to obtain an overall view of the total commuter market for 20 to 70 seats since the same weight cannot be given to a 30-seat type as to a 60-seat type. The market shares are accordingly as follows ([1]):

(in percent)

20 to 70 seats					
World			EEC		
ATR	29	50	ATR	49	65
+			+		
DHC ([1])	21		DHC	16	
Saab	18		Fokker	12	
Embraer	13		BAe	8	
Fokker	9		Embraer	6	
BAe ([2])	4		Saab	5	
Casa	3		Casa	3	
Dornier	3		Dornier	1	

([1]) DHC = de Havilland.
([2]) BAe = British Aerospace.

(26) It follows from these figures that:

— in the relevant product market of 40 to 59 seats the new entity would obtain about 64 % of the world market and about 72 % in the Community,

— in the relevant product market of 60 seats and above, the new entity would have about 76 % of the world market and about 74 % in the Community,

— ATR and DHC after a merger would obtain worldwide a share of about 50 % of the overall commuter market and about 65 % in the Community.

4. Impact of the concentration

A. *Effect on ATR's position*

(27) The proposed concentration would significantly strengthen ATR's position on the commuter markets, for the following reasons in particular:

— high combined market share on the 40 to 59-seat market, and of the overall commuter market

— elimination of de Havilland as a competitor

— coverage of the whole range of commuter aircraft

— considerable extension of the customer base.

(a) Increase in market shares

(28) The proposed concentration would lead to an increase in market shares for ATR in the world market for commuters between 40 to 59 seats from

([1]) The market share figures do not vary significantly if options are taken into account, converted for all aircraft on the basis of the high rates achieved for the successful ATR programme in the past. The figures on this basis are:
— World: ATR + DHC = 47 % (nearest competitor, Saab 21 %),
— Community: ATR + DHC = 66 % (nearest competitor, Fokker 12 %).
If the figures are calculated alternatively on the basis of list prices of each aircraft as opposed to a weighting by seats, the figures on the basis of firm orders are:
— World: ATR + DHC = 47 % (nearest competitor, Saab 20 %),
— Community: ATR + DHC = 64 % (nearest competitor, Fokker 13 %).
The figures calculated on the basis of list prices and also taking into account options are:
— World: ATR + DHC = 44 % (nearest competitor, Saab 23 %),
— Community: ATR + DHC = 64 % (nearest competitor, Fokker 13 %).
[...]

46 % to 63 %. The nearest competitor (Fokker) would have 22 %. This market, together with the larger market of 60 seats and above where ATR has a world market share of 76 %, is of particular importance in the commuter industry since there is a general trend towards larger aircraft. This trend is particularly marked in Europe since airport fees favour the use of larger aircraft because of the crowded skies and limited airport capacities. Already at the end of 1990 84 % of total commuter seat capacity ordered in the Community was accounted for by aircraft of 40 seats and above, compared to 57 % worldwide. The trend towards larger aircraft in Europe can be seen in the geographic breakdown of the sales of the various types. Whilst for the 48-seat ATR 42, 44 % of the aircraft have been sold in Europe and 39 % in North America, for the 66-seat ATR 72, 67 % have been sold in Europe and 19 % in North America. For de Havilland, 14 % of the 36-seat Dash 8-100 aircraft have been sold in Europe and 78 % in North America, whilst 58 % of the 50-seat Dash 8-300 aircraft have been sold in Europe and 35 % in North America. The counterpart of larger aircraft becoming more important in Europe is that aircraft in the 30-seater market are relatively more important in North America than Europe. Embraer for example has sold 71 % of its 33-seat aircraft in North America compared with only 18 % in Europe.

(29) ATR would increase its share of the overall worldwide commuter market of 20 to 70 seats from around 30 % to around 50 %. The nearest competitor (Saab) would only have around 19 %. On the basis of this the new entity would have half the overall world market and more than two and a half times the share of its nearest competitor.

(30) The combined market share may further increase after the concentration.

The higher market share could give ATR more flexibility to compete on price (including financing) than its smaller competitors. ATR would be able to react with more flexibility to initiatives of competitors in the market place.

Following a concentration between ATR and de Havilland, the competitors would be faced with the combined strength of two large companies. This would mean that where an airline was considering placing a new order, the competitors would be in competition with the combined product range of ATR and de Havilland. The sales strategy of the formerly separate companies would now be concerted. The combination could enable the new entity ATR/de Havilland to be more flexible in setting its price than its competitors where a sale is contestable, because of their absolute size advantage in terms of sales base. Furthermore, unlike the competitors, the combined entity would have all the advantages of a family of commuters to offer. This may give rise to the ability, *inter alia,* of offering favourable conditions for a specific type of aircraft in mixed deals. It may be conceivable that, for example, where an airline wants to acquire a small commuter of around 30 seats and a commuter of around 60 seats, the ATR/de Havilland could offer special conditions for the ATR 72 when it is ordered with a Dash 8-100 where more competition is likely. The parties state that in practice there is no chance of mixed deals taking advantage of market power in one segment to sell in another. However, in comments introduced by economic consultants on the parties' behalf, reference is made to the ability of the combined entity to package together regional aircraft.

The parties themselves expect that the aggregation of ATR and de Havilland marketing and manufacturing forces 'will certainly lead to an improvement of their position in North America and Europe among the regional aircraft producers', so that the position of the combined entity would be stronger than that of ATR and de Havilland currently.

(b) Elimination of de Havilland as a competitor

(31) In terms of aircraft sold, de Havilland is the most successful competitor of ATR. In the relevant product market of 40 to 59 seats, Fokker has a higher market share than de Havilland, but Fokker at the end of 1990 had a backlog of only 27 orders for the Fokker 50 whilst de Havilland had a backlog of 72 orders for the Dash 8-300 (second only to ATR with 103 orders for the ATR 42).

Furthermore, de Havilland has plans to develop a new aircraft — the Dash 8-400 — to compete in the top segment (60 seats and over) [1]. If the concentration goes ahead, therefore, de Havilland would be eliminated as a potential competitor from this segment where ATR has a market share of 76 %.

[1] Boeing has currently suspended this programme in order to give the buyer of de Havilland an opportunity to conduct its own programme analysis to determine what action would be taken after the sale.

The parties argue that if the proposed concentration does not proceed, although de Havilland would not be immediately liquidated, its production might be phased out by Boeing so that de Havilland might in any case be eliminated as a competitor in the medium to long term. Without prejudice as to whether such a consideration is relevant pursuant to Article 2 of the Merger Regulation, the Commission considers that such elimination is not probable.

According to a pre-acquisition review of de Havilland carried out for Aerospatiale-Alenia at the end of 1990, the following factors, *inter alia,* were identified as critical in assessing the investment decision from a business/financial point of view: de Havilland produces high quality, well-known and highly respected products, the net selling prices of which have been increasing; progress has already been made in reducing excess employees, and relations with trade unions have improved; there is still however scope for further improvement in production management since de Havilland's productivity is relatively poor [...] (1).

On the evidence made available to the Commission, there is therefore no likelihood that de Havilland, in the absence of the proposed concentration, would in any case be phased out. Boeing has however expressed its preference to sell de Havilland rather than continue to operate it. This would seem possible given that the parties are not the only potential buyers. British Aerospace, for example, has expressed an interest to buy de Havilland.

(c) Coverage of the whole range of commuter aircraft

(32) The new entity ATR/de Havilland would be the only commuter manufacturer present in all the various commuter markets as defined above.

Embraer sells only a commuter type in the 20 to 39-seat market. Fokker and Casa are represented only in the 40 to 59-seat market, and British Aerospace is not represented in the 40 to 59-seat market. Saab is predominantly active in the 20 to 39-seat market. The new 50-seater Saab 2000, which will be delivered from 1992/1993 onwards, is a fast turbo-prop commuter which meets a special need for customers operating regional routes of relatively long distances.

It appears that, in the sector concerned, having a complete range of products would give ATR/de Havilland a significant advantage in itself. From the demand side, airlines derive cost advantages from buying different types from the same seller. It was stated in the oral hearing by British Aerospace, for example, that in forecasting future sales of the 64-seat ATP it is assumed that existing customers for the 48-seat ATR 42 acquire the 66-seat ATR 72 when they identify a need for a larger plane. There is currently competition between ATR and British Aerospace for the uncommitted business, including that of existing de Havilland customers. If the proposed concentration were to proceed, the Dash 8 customers would be seen by British Aerospace as committed to the new combined entity also for their requirements for larger planes.

According to a study submitted by the parties, it is argued that the inability of a manufacturer to offer a full range of seating capacities under the same umbrella may harm the demand for other existing aircraft of that manufacturer. Thus, a significant regional carrier whose aircraft needs may call for a full complement of aircraft capacities to meet the route needs of that carrier might be dissuaded from purchasing smaller aircraft from a single manufacturer if the needs of the carrier for a larger aircraft could not also be met from the same aircraft manufacturer. This logic flows from the fixed costs borne by the carrier for each aircraft manufacturer dealt with by that carrier. These costs include the fixed costs of pilot and mechanic training as well as the costs of maintaining different in-house inventories of parts and the fixed costs of dealing with several manufacturers when ordering parts stocked only by the individual manufacturers themselves.

One of the stated main strategic objectives of the parties in acquiring de Havilland is to obtain coverage of the whole range of commuter aircraft. The competitive advantages which would arise from this would emerge over time.

The parties' economic consultants state that having products available across the broad spectrum of market potential reduces considerably the risk associated with future demand.

In the short term, ATR and de Havilland would establish common marketing and product support which may result in some cost savings for the combined entity. It may be possible later to further rationalize product support by increasing the 30 % commonality of spare parts between ATR and de Havilland which already exists. This rationalization would have cost-saving implications also for customers where they acquire aircraft types of both ATR and de Havilland.

(1) Analysis of financial position of de Havilland.

In practice the advantages of having complete coverage of the market are only present where airlines have or intend to have a fleet consisting of aircraft in different product markets. According to figures supplied by Fokker, over half of the aircraft sold in the markets of 40 seats and above for example are operated in fleets where there are also aircraft of around 30 seats. It appears therefore that at least having a more complete coverage of the market is significant.

(d) Broadening of customer base

(33) ATR would significantly broaden its customer base after the concentration. On the basis of deliveries to date, the parties state that ATR has currently delivered commuters to 44 customers worldwide and de Havilland has delivered commuters to 36 other customers, giving a combination of 80 customers in all. This compares with, for example, Saab which has 27 operating airline customers, and Fokker which has around 20 airline customers operating the Fokker 50. This figure of 80 customers does not take into account however the substantial backlog of orders not yet delivered of both companies placed by yet other customers. It is likely therefore that the customer base would be higher in the foreseeable future. This is already reflected in the market share figures.

The customer base is an important element of market power for aircraft manufacturers since there is at least to some extent a lock-in effect for customers once their initial choice of aircraft is made.

Once a customer has made a commitment to a particular manufacturer, then there is usually a cost consideration in placing orders with another manufacturer. Customers indicate that there are relatively high costs arising from different technology used leading to training costs for maintenance and for pilots, and to different spare part requirements. The analysis of the fleets of the airlines shows that all airlines have only one type of new generation aircraft within a particular relevant product market. Furthermore, where airlines have aircraft from different relevant product markets, the fleet analysis shows that they always operate aircraft of the same manufacturer across different markets where the manufacturer produces types of the size required, e.g. Brymon Air operates a fleet of Dash 8-100 and Dash 8-300 aircraft, NFD operates a fleet of ATR 42 and ATR 72 aircraft. This applies equally to airlines which have very large fleets such as American Airlines. The only examples of mixed manufacturer fleets are where the airlines operate 50-seater ATR or Fokker aircraft together with aircraft in the small 30-seater market. This is inevitable since neither ATR nor Fokker produce aircraft of this category.

The analysis is the same if the outstanding orders of airlines are examined. The only airline which has ordered a different aircraft to the type it is already operating in a particular category has chosen to replace its current small Fokker 50 fleet by the new Saab 2000. It already operates a large number of Saab 340 aircraft.

The established airlines who have already acquired ATR or de Havilland commuters are therefore likely to stay with them in placing future orders.

The likelihood is thus that ATR/de Havilland would retain at least the current level of customers.

B. *Assessment of the strength of the remaining competition*

(34) In order to be able to assess whether the new combined entity would be able to act independently of its competitors, in view of its strengthened position, it is necessary to assess the current and expected future strength of the remaining competitors.

(35) As to the competitors, a distinction can be drawn between those which are medium-sized specialists and those which belong to large groups in which commuters form a relatively small part of their overall aerospace activity.

The medium-sized competitors

(36) *Fokker* has been a successful competitor in the 40 to 59-seat market in the past. It now produces however only one commuter (the Fokker 50) and does not have a family of products to offer. Because of its relatively limited resources, it has only one other significant product, the Fokker 100 jet. Its military business is very limited.

The Fokker 50 has a relatively low share of 9 % of the overall worldwide market of 20 to 70 seats and 22 % of the market of 40 to 59 seats where ATR/de Havilland combined would have 63 %. It has only 5 % of the worldwide backlog of commuter orders (overall market), representing less than one year of Fokker's production capacity at the end of 1990. Fokker may benefit to a certain extent from some customer loyalty from its sales of the Fokker 27 aircraft in the 1960s and 1970s. The low market share achieved by the Fokker 50 however shows that this has not been a significant factor. There has not been, in any event for customers, a lock-in effect from these old aircraft since the Fokker 50 is a new technology aircraft. It is considered that Fokker's relative success with the Fokker 100 jet would have no effect on sales of the Fokker 50. Although there are some production synergies between the Fokker 50 and Fokker 100, the market success of the two aircraft is not linked. Fokker's experience shows that customers who acquire the Fokker 100 jet are not influenced by this in their decisions as to which 50-seat turbo-prop to acquire. As outlined in the notification, Boeing's experience with de Havilland confirms that there are no significant marketing synergies between jet and turbo-prop aircraft.

Fokker could be particularly affected by the combined strength of ATR/de Havilland. It has not yet built up a large customer base for the Fokker 50 and has smaller resources than ATR. After a concentration between ATR and de Havilland, it would be more difficult for Fokker to broaden its product range of commuters by producing a stretch version of the Fokker 50 given the outlined competitive advantages of the new entity. The concentration may have in this light a crucial impact on the situation of Fokker as a competitor in the aircraft market.

(37) *Casa* is only present on the market of 40 to 59 seats so far in a marginal way with an aircraft derived from a military version. Casa has however intentions to increase its participation in the civil aircraft markets, and to develop a new commuter so as to diminish its existing dependence on the military markets.

It would not be easy for Casa to maintain its plans to develop this new commuter following completion of the proposed concentration, since Casa will find it difficult to compete against the market power of the combined entity ATR/de Havilland. The proposed concentration will impede Casa becoming a significant competitor in the civil aircraft market generally.

(38) *Embraer* has stated that it will remain in the small segment (20 to 39 seats) with its current commuter type. Embraer is a Brazilian company which has concentrated its resources in the development of a new regional jet. It was announced in July 1991 however that this project — the EMB 145 — has been cancelled. Although the EMB 145 was said to be a good product, Embraer considered that it would be putting it on the market too late. It is questionable whether Embraer will now be able to develop a commuter type in the larger segments since the existing competitors in those segments have already been present for some time. Futhermore, after completion of the proposed concentration, it is less likely that Embraer could compete effectively in these segments against ATR/de Havilland.

The large aerospace groups

(39) *British Aerospace* has the resources to broaden its current product range in the commuter markets. Its current market share is however small (4 % of the overall world commuter market) and it has only 2 % of the worldwide backlog of commuter orders, representing less than one year of its production capacity at the end of 1990. Future investment in the commuter markets by British Aerospace would depend on whether there exist more profitable opportunities elsewhere in the group and whether a stronger commitment to the commuter markets would be rational. Other than its broad aerospace activities, British Aerospace has significant interests in non-aerospace industries including cars, telecommunications and property.

In adjacent markets, British Aerospace manufactures the 19-seat turbo-prop aircraft J31 and the 95-seat BAe 146 jet. There are production synergies between the J31 and 27-seat J41 and also between the 64-seat ATP and the BAe 146 jet arising from production in the same factory and sharing of common costs. There may be limited competitive advantage for the British Aerospace J41 arising from the existence of the small J31, but this will not be significant in the future in particular in the Community. The market for small aircraft of below 20 seats has been in overall decline since the early 1980s and in fact has always been relatively small within the Community. As for Fokker with the Fokker 100 jet and Fokker 50 turbo-prop, no competitive advantage is gained for the ATP turbo-prop from selling the BAe 146 jet. As for Fokker from the old F27 aircraft, there may be some customer loyalty to British Aerospace resulting from the sales in the 1960s and 1970s of the 46-seat HS748, although this aircraft was not in the same product market as the current 64-seat ATP. The low number of orders achieved by the ATP however shows that this has not been a significant factor.

Following the completion of a concentration between ATR and de Havilland, since British Aerospace has only a very small customer base in the commuter markets, it is doubtful that it would focus on these markets. It already has an identifiable gap between its two existing models in the key product market of 40 to 59 seats. Furthermore, the already difficult competitive situation for the 64-seat ATP *vis-à-vis* the 66-seat ATR72 would be worsened after completion of the proposed concentration, given the strength of the new entity.

The proposed concentration will therefore lead to British Aerospace becoming further marginalized as a competitor in the commuter markets.

(40) *Saab* can be expected to stay in the 20 to 39-seat market where it has a relatively healthy position. It is developing a 50-seat fast turbo-prop commuter which is expected to come on the market in two years time. This may to a certain extent only be a limited competitor to ATR and de Havilland since it meets a special need for customers operating regional routes of relatively long distances. The turbo-Prop markets generally are short-haul markets with flights of an average of around one hour. Because take-off and landing times are a relatively high proportion of the overall flight time for short routes, speed is not so relevant since only some five minutes can be shaved off a particular flight by even the 25 % increase in speed envisaged for the Saab 2000. It may be therefore that most customers would not be willing to pay a premium for this plane. This implies that this plane, given its technical and cost characteristics, will occupy a niche market which will not compete directly in the market for 40- to 59-seat commuters.

(41) *Dornier,* which is part of the Daimler-Benz group via Deutsche Aerospace (DASA), will enter the small commuter market with a 30-seat type in 1993. In assessing DASA's future competition with ATR, however, it must be noted that a Memorandum of Understanding has been entered into between DASA and Aerospatiale and Alenia as to future development of a regional jet. If the decision is taken to develop this regional jet, it is intended that these companies would then form the joint venture 'International Commuter' for the marketing of the whole range of regional aircraft, including commuters, manufactured by the three companies. If International Commuter is formed in this way, Dornier would not remain a real competitor of ATR/de Havilland. The formation of International Commuter is not however yet definitely decided and would be subject to review under the Community competition rules. If DASA does not enter into a final agreement with Aerospatiale and Alenia, then it may become a significant competitor in the 20 to 39-seat market.

Overall evaluation of the remaining competition

(42) It follows from the above that effective competition for the combined entity would only be maintained in the market of 20 to 39-seat commuters, although even here the ability of the competitors to compete with the combined entity would lessen to a certain extent given the overall advantages to ATR/de Havilland arising form a broad sales base and coverage of all the markets. In the markets for commuters of 40 seats and over, apart from the limited competition from the Saab 2000, it is questionable whether the other existing competitors could provide effective competition in the medium to long term.

C. *Assessment of the customers*

(43) In order to be able to assess whether the new combined entity would be able to act independently of customers, in view of its strong position and the relative weakness of the competitors, the position of customers in the commuter markets must be examined.

(44) Regional transport has evolved over recent years. The market has benefited from deregulation and liberalization policies, first in North America and now in Europe. According to the notification, it is expected that there will be a need for additional commuters which would go beyond mere replacement of existing aircraft.

The impact of the proposed merger in this context is not the same for the established airlines as for airlines yet to emerge.

(45) The established airlines which have already acquired ATR or de Havilland commuters are for the reasons outlined in point (33) likely to stay with them in placing future orders. In view of the lock-in effect, these customers consider themselves tied to the manufacturer who supplied the aircraft. This limits their bargaining power in placing future orders even if they are subsidiaries of major airlines.

(46) New airlines or established airlines replacing an entire fleet will have initially a free choice because there is no lock-in effect at that moment.

New airlines which are small-scale operators, typically trying out new routes, would have a relatively weak bargaining position since they will acquire only a limited number of aircraft. They will in fact frequently enter the market through leasing rather than buying aircraft. New airlines (or established airlines replacing an entire fleet) which are subsidiaries of major airlines may have more bargaining ability in those cases where the parent companies place large orders. Some American companies may have such ability. There are no similarly large-scale European regional carriers for the time being. To the extent that any bargaining ability exists amongst these airlines, it would be reduced by the elimination of an important competitor from the markets.

(47) Leasing companies offer bridging facilities for new market entrants wishing to avoid the exposure of long-term ownership, at least at the outset. It is likely therefore that leasing will be a significant means of market entry given the high capital cost of aircraft and the risk of failure.

Leasing companies at the end of 1990 had placed 170 orders for commuter aircraft, [...] (1) of which are accounted for by ATR and de Havilland ([...] ATR and [...] de Havilland). This amounts to some 10 % of the overall worldwide market. Leasing companies act as intermediaries between manufacturers and airlines facilitating the acquisition by airlines of new equipment on a flexible basis.

Since ieasing companies place their orders for aircraft without knowing where they will be leased, they must predict which products their potential customers will require. The leasing companies therefore usually only buy the products which are best established on the market to avoid the risk of being left with stocks. The buying policy of leasing companies therefore reflects existing majority customer preferences. Leasing companies could be seen therefore as market followers rather than market makers, accentuating demand, their success depending on the popularity of the products acquired. This is a significant constraint on the ability of leasing companies to exercise bargaining power where there is insufficient competition on the markets, since they cannot take the risk of being left with stocks of unpopular products.

This analysis is confirmed by the views of the Irish-based GPA group, which is the world's largest aircraft leasing company. GPA has acquired only ATR and de Havilland commuters, partly through a joint venture company in which ATR has a 25 % interest. The decision to buy these aircraft was based on the assessment that these aircraft were among the most popular on the market. It was considered that they would provide an attractive leasing product to a wide range of customers due to their being part of a family of aircraft, technical strengths, record of innovation and marketing support.

It would therefore not be easy for the leasing companies to switch to other manufacturers because of the risk of being left with stock. The products of the other manufacturers are not as popular and would be more difficult to place. The proposed concentration thus significantly reduces the choice for leasing companies and can be expected to lead to a situation in which they may depend to a certain extent on ATR/de Havilland.

(48) From the customers' replies to the Commission's enquiry, it seems that most established airlines found it difficult to assess the impact of the proposed concentration on the general conditions of competition based on the information available to them. Half of the respondents stated that there would be not direct impact on their company since they already have a committment to a particular commuter manufacturer and have thus no plans, nor even a realistic possibility, to switch to another manufacturer. Some of these airlines have already placed their orders to fulfil their medium-term demand and others anticipate no further orders. 25 % of the airlines which replied nonetheless expressed concern about the reduction of choice and elimination of competition which they perceived to be a direct result of the concentration.

It appears therefore that for most established airlines a direct negative effect form the proposed concentration would only appear over time. The

(1) Almost all.

impact would be immediate for airlines which will come on to the market in the future, in particular following deregulation in the Community.

(49) Even if in general terms customers would want to switch to a significant extent to the competitors of ATR/de Havilland, there is only a limited possibility given that the existing capacity of each competitor on average is estimated to be capable only of an increase of some 15 to 20 % in one to two years. This amounts to under 10 % of the overall current worldwide commuter production capacity.

(50) The parties claim that in the future customers may have the possibility of acquiring second-hand aircraft and that these would compete with new aircraft to a certain extent.

It is not considered that second-hand aircraft will significantly compete with new aircraft even in the long term. As stated by the parties, there is for the time being no significant second-hand market. It has also been stated by the parties that the older aircraft which are replaced by new aircraft are relegated to secondary needs. These secondary needs include freight and postal transport which is a completely different type of demand to the demand for passenger transport. The second-hand market is therefore likely to be a different market from that for new aircraft.

D. *Summary of effect of the proposed concentration on the commuter markets*

(51) The combined entity ATR/de Havilland will obtain a very strong position in the world and Community commuter markets of 40 seats and over, and in the overall world and Community commuter market, as a result of the proposed concentration. The competitors in these markets are relatively weak. The bargaining ability of the customers is limited. The combination of these factors leads to the conclusion that the new entity could act to a significant extent independently of its competitors and customers, and would thus have a dominant position on the commuter markets as defined.

(52) The proposed concentration would create a dominant position even if the parties' definition of the relevant product market as that of the overall market of 20 to 70-seat aircraft were considered correct.

ATR would increase its market share in this market from 29 to 50 % worldwide and from 49 to 65 % within the Community. The effects of the strengthening of ATR's position in terms of higher sales base, the coverage of the whole range of commuter aircraft and the broadening of the customer base would be the same on this larger market as outlined for the markets of 40 to 59 seats and 60 seats and above.

Furthermore, the market power of ATR/de Havilland in an overall commuter market is even stronger than is reflected in the market shares. In the overall commuter market, there is an identifiable general trend towards larger aircraft in particular in the Community as explained in point (28). The higher segments therefore have a strategic importance for the overall commuter market both now and in the future. The evaluation of market power must reflect this dynamic of the market and take into account the fact that a competitor is particularly strong in the strategic parts of th overall market. The extremely strong position which would be obtained by ATR/de Havilland in the higher segments together with the other structural factors as outlined above leads to the conclusion that a dominant position would also be created on an overall market of aircraft of 20 to 70 seats.

E. *Potential entry into the market*

(53) In general terms, a concentration which leads to the creation of a dominant position may however be compatible with the common market within the meaning of Article 2 (2) of the Merger Regulation if there exists strong evidence that this position is only temporary and would be quickly eroded because of high probability of strong market entry. With such market entry the dominant position is not likely to signficantly impede effective competition within the meaning of Article 2 (3) of the Merger Regulation. In order to assess whether the dominant position of ATR/de Havilland is likely to significantly impede effective competition therefore, it is necessary to assess the likelihood of new entry into the market.

(54) Any theoretical attractiveness of entry into the commuter market by a new player must be put into perspective taking into account the forecast demand and the time and cost considerations to enter the market.

Based on the parties' figures, the overall market potential for 20 to 70-seat commuter aircraft over the next 20 years is estimated at around [...] units. including the backlog of around 700 units. It is expected that the current level of demand will be maintained only until the mid-1990s, and thereafter decline and stabilize. The average annual level of demand from the mid-1990s onwards could then be estimated at around [...] (1) units compared to the current rate of some [...] units.

It follows that in terms of increase in annual deliveries the market appears to have therefore already reached maturity.

(55) Even for a company currently active in a related industry not already present on the commuter market — in practice this would seem to be limited to large jet aircraft manufacturers — it would be very expensive to develop a new commuter from scratch. According to the study submitted by the parties, there are high sunk initial costs of entering the regional aircraft market and delays in designing, testing and gaining regulatory approval to sell the aircraft. These are important for several reasons. The critical point is that with substantial fixed and sunk costs of entering the industry, these markets will be viable only for a limited number of producers. Furthermore, once a manufacturer is committed to the design and production of an aircraft, it is extremely costly and lengthy to adjust that design and production to unanticipated changes in market demand for aircraft. Critical design features of the aircraft include its size, weight, engine specifications with attendant pay-load, fuel efficiency and distance capacity. The magnitude of the initial sunk development costs of the aircraft constitutes a significant risk associated with commitment to a particular aircraft. If the manufacturer errs in design, these initial costs are not recoverable.

In terms of time, the study states that it takes approximately two to three years of marketing research to determine which plane is required to meet the anticipated needs of the market. This involves forecasting changes in aircraft technology as well as forecasting the evolving nature of the market. From the point of initial research and development to the point of producing and delivering aircraft, an additional four years would likely elapse. The total time lag involved is of the order of six to seven years. This does not include any time required to construct or acquire plant facilities necessary for aircraft construction.

The study concludes that there is no doubt that the presence of substantial and fixed entry costs significantly reduces the entry response by others to any successful aircraft by one manufacturer.

(56) It follows from the above that a new entrant into the market would face high risk. Furthermore, given the time necessary to develop a new aircraft and the foreseeable development of the market as described above, a new manufacturer may come too late into the market to catch the expected period of relatively high demand. Any new market entry at this stage could only come when the market would have declined from current levels and have stabilized. It is therefore doubtful whether a break-even level of sales could be achieved by a new entrant since even existing competitors are not yet at break-even point in their product cycles.

(57) For these reasons it is considered that it would not be rational to now enter the commuter aircraft market. This is accepted by the parties. The parties argue however that some newly industrialized countries would decide nonetheless to support the development of a local commuter industry. Even if some time in the future such a local commuter industry were established in the way the parties suggest, it is considered unlikely that significant inroads into the international markets could occur in this way. Such an uncertain possibility would not in any case be sufficient to justify a conclusion that the dominant position of ATR/de Havilland is only temporary.

As to market entry in the foreseeable future, furthermore, there is no known development programme by a company not yet on the market other than as assessed below. All competitors contacted consider that it is not probable that there will be another entrant into the market because, given the current structure of the market, the level of development costs is out of all proportion to any possible return.

(58) The parties cite Aero Czechoslovak Aeronautical Works (ACAW) as a manufacturer which could enter the relevant commuter market with its 40-seat turbo-prop aircraft, LET 610, within the next five years. This aircraft has been designed to

(1) Substantially lower: around two-thirds of current rate.

meet the requirements of the markets of the Soviet Union and the other former Comecon countries. This aircraft has been in development since 1977 and is now only at the stage of prototype testing. In 1989, a decision in principle was taken to develop a version which would meet the requirements of western certifications, and it is envisaged to equip this variant with engines from General Electric. It may be difficult, however, for ACAW to enter the relevant markets without a partner established in these markets since ACAW may not be able to set up alone the necessary maintenance and product support facilities. Furthermore, the LET 610 is of unproven reliability since it has not yet flown and ACAW has no experience at all in the commuter markets affected by the proposed concentration as defined. It will be difficult for ACAW to obtain the necessary credibility for western airlines to seriously consider evaluating its aircraft.

This manufacturer is not therefore considered to be a realistic potential entrant, or alternatively, if it were to enter, it would not play a significant role in the foreseeable future.

(59) The parties also cite the Indonesian company, Industri Pesawat Terbang Nusantara (IPTN), as a manufacturer which could enter the western commuter market with the 50-seat turbo-prop aircraft N250. IPTN has collaborated with Casa in the development of the CN235, but to date has not itself developed a commuter aircraft. First plans for the N250 were made in 1987, and it is expected to only obtain its first certification in 1996 at the earliest. This aircraft seems likely to be successful in Indonesia which has an estimated potential demand for 400 aircraft over the next 20 years. It may be possible for IPTN also to sell outside Indonesia to a certain extent. Sales outside Indonesia would however be dependent on IPTN establishing the reliability of the new aircraft which would take several more years following certification.

In this light, sales outside Indonesia are a matter of speculation only, and would not occur within a time-scale where IPTN could be taken into account as a significant potential competitor under the Merger Regulation.

(60) The parties also mention the Ilyushin 114 which has been developed for the Soviet Union and the former Comecon countries. The first deliveries of this aircraft are expected in 1992 to Aeroflot. The parties state that this aircraft will not compete in Europe or North America. This analysis appears correct. The main importance of the Ilyushin 114 is considered to be as the future main aircraft (perhaps with the aircraft of ACAW) of the eastern geographic area.

(61) Boeing, which is selling de Havilland, has stated in response to a specific request that it has no intention of re-entering the market for turbo-props, and will concentrate its activities on jet aircraft and helicopters. Its experience with de Havilland has demonstrated that no significant synergies exist between manufacturing jet aircraft and manufacturing turbo-prop aircraft. The parties state that at the basis of Boeing's decision to sell de Havilland lies the consideration of the weaker than expected link between regional and large civil aircraft.

There is no indication either that McDonnell Douglas or Lockheed as the other main North American jet manufacturers have any intention of entering the turbo-prop markets. Even in the period of high growth in the North American markets in the early 1980s these manufacturers did not enter.

(62) There are currently no Japanese manufacturers of commuters. Furthermore, the Japanese are largely not present in the aircraft industries in particular because of a post-war treaty prohibiting production and exportation of aircraft until 1995. It may be therefore that in the future Japanese manufacturers would be interested in playing a certain role in the aerospace industry. It is, however, questionable whether the commuter market would be a focus given its apparent lack of strategic and technical interest within the aerospace industry generally, and the risks of unprofitable trading as outlined above. It is considered therefore that there is no identifiable Japanese potential entrant.

Evaluation of the possibility of new entry

(63) It follows that there is no realistic significant potential competition in the commuter markets in the foreseeable future.

The parties claim that the commuter markets are volatile on the basis that in the early 1980s Fokker and British Aerospace had high market shares and this did not prevent significant market entry, notably of ATR.

A change in market structure from the early 1980s to the early 1990s does not demonstrate that these markets are volatile. The situation in the early 1980s was very different from the current situation.

The markets in the early 1980s were characterized by the following factors :

— there were very few competitors on the markets. In the small commuter market of 20 to 39 seats, there was only Shorts, and in the market of 40 to 59 seats there were only Fokker, British Aerospace and to a limited extent de Havilland,

— the aircraft on the markets and in particular those of Fokker and British Aerospace were very old, even obsolete, products. The markets were ripe for the introduction of new and better performing aircraft,

— forecasts showed that there would be high growth in the markets over the following decade arising from deregulation in North America. These forecasts proved justified,

— the markets were therefore attractive to new entrants and it was rational for entry to occur.

The markets in the early 1990s, in contrast, are characterized by the following factors :

— there are eight competitors altogether already on the markets. The aircraft available are all based on modern technology which fulfils the stringent customer requirements in this respect for the foreseeable future,

— current forecasts as outlined above show that the markets are approaching maturity and will decline and stabilize from the mid-1990s,

— the markets are not therefore attractive to new entrants, and it is not rational to now enter. The expectation is rather that some of the existing competitors will leave.

(64) It is considered therefore that a change in market structure similar to that which took place in the 1980s is unlikely to recur in the 1990s. Furthermore, the possibility of market entry would be further reduced if the proposed concentration goes ahead.

F. *Other general considerations*

(65) The parties argue that one of their objectives in acquiring de Havilland is to reduce costs. The potential cost savings arising from the concentration which have been identified amount to only some ECU 5 million per year. According to the estimates of the parties' economic consultants, these cost savings to the combined entity would arise from rationalizing parts procurement, marketing and product support.

Without prejudice as to whether such considerations are relevant for assessment under Article 2 of the Merger Regulation, such cost savings would have a negligible impact on the overall operation of ATR/de Havilland, amounting to around 0,5 % of the combined turnover. The parties have identified (although not quantified) cost savings which could be made by better management of certain aspects of de Havilland's internal operation. These cost savings would not arise as a consequence of the concentration *per se,* but are cost savings which could be achieved by de Havilland's existing owner or by any other potential acquirer.

(66) The parties have not claimed that cost savings will arise from combining the research and development activities of ATR and de Havilland. This is in line with undertakings given to the Canadian authorities to maintain de Havilland as a full-function aircraft manufacturer.

(67) ATR's current position in the industry is very healthy. Given the relatively high initial costs of development for new aircraft, it is normal for manufacturers in this industry to show losses in the early years of a programme. It takes some time before a sufficient level of sales has been achieved to amortize the development costs. [...] (1).

Since ATR has also established an excellent position in the market, and efficient production management, it does not need to obtain by acquisition further capacity or market shares in order to guarantee its long-term success as a major player in the worldwide commuter industry.

(68) The parties have stated that a competitive advantage (which has not been quantified) will be obtained from acquiring de Havilland by enabling manufacturing in a dollar area to reduce the currency fluctuation risk. For the ATR product range this will only arise, however, to the extent that production could be shifted between Europe and North America.

(1) ATR financial projections.

Although some advantage may be obtained from a dollar manufacturing base, it should be noted that no competitor other than de Havilland has such a base. It is doubtful in practice that production of ATR aircraft would be transferred to Canada in any significant way.

(69) For the above reasons, the Commission does not consider that the proposed concentration would contribute to the development of technical and economic progress within the meaning of Article 2 (1) (b) of the Merger Regulation. Even if there was such progress, this would not be to the consumers' advantage.

The consumers will be faced with a dominant position which combines the most popular aircraft families on the market. Choice will be significantly reduced. There is a high risk that in the foreseeable future, the dominant position of ATR/de Havilland would be translated into a monopoly.

Both British Aerospace and Fokker, the two principal competitors in the markets of 40 seats and above, have stated that the concentration would seriously jeopardize the survival of the ATP and Fokker 50 aircraft. These two competitors expect that the proposed concentration would lead to ATR/de Havilland pursuing a strategy of initially lowering prices so as to eliminate the competitors at least in the key markets of 40 seats and above.

Neither Fokker nor British Aerospace consider it possible for them to withstand such a price war. Consequently, both would leave the markets.

In evaluating these statements, it is noted that such conduct could be rational since the proposed concentration would mean that ATR/de Havilland would exceed the threshold of market shares which would make such a pricing policy likely given that it would be the optimal profit-maximizing strategy.

Having established a monopoly, ATR/de Havilland would be able to increase prices without any competitive check.

(70) With this perspective, the proposed concentration would become even more harmful to the customers over time as the dominant position translates to a monopoly. Higher prices for commuters have a proportionally large impact on regional airlines since the price of an aircraft accounts for some 30 to 40 % of their total operating costs.

(71) The proposed concentration would also lead to adverse effects in the adjacent 100-seat jet market. The British Aerospace BAe 146 jet is produced in the same factory as the ATP commuter so that fixed costs are spread over the two aircraft. A similar interdependency exists between the Fokker F100 jet and the Fokker 50 commuter. Removal of the commuter product lines of both companies would therefore weaken their competitiveness in the 100-seat jet market where they are already facing strong competition from the Boeing 737.

V. CONCLUSION

(72) For the reasons outlined above, it is considered that the proposed concentration would lead to a situation whereby the combined entity ATR/de Havilland could act to a significant extent independently of its competitors and customers on the world markets as defined for commuters of 40 to 59 seats and 60 seats and over. The proposed concentration therefore creates a dominant position on the world markets. Furthermore, according to the above analysis, this dominant position is not merely temporary and will therefore significantly impede effective competition. It is considered that such a dominant position is also created even if the relevant product market is the overall 20 to 70-seat market.

The conditions of competition in the Community commuter markets are not appreciably different from those prevailing in the overall world markets. The market shares of the new entity would be similar in both the world and Community markets for commuters of 60 seats and over, and even higher in the Community market for commuters of 40 to 59 seats than in the world market. These markets are also relatively more important in the Community than in the rest of the world. As to the overall market of 20 to 70 seats, the market shares of the new entity would be higher in the Community than in the rest of the world. It is considered therefore that the proposed concentration creates a dominant position which significantly impedes effective competition in the common market within the meaning of Article 2 (3) of the Merger Regulation,

HAS ADOPTED THIS DECISION:

Article 1

The proposed concentration between Aerospatiale and Alenia and de Havilland is declared incompatible with the common market.

Article 2

This Decision is addressed to:

Aerospatiale SNI,
37 Boulevard de Montmorency,
F-75781 Paris Cedex 76,

and

Alenia-Aeritalia & Selenia Spa,
P. le V. Tecchio 51/a,
I-80125 Napoli.

Done at Brussels, 2 October 1991.

For the Commission
Leon BRITTAN
Vice-President

OPINION

of the Advisory Committee on Concentrations given at the eighth meeting on 20 September 1991 concerning a preliminary draft decision relating to Case IV/M.053 — Aerospatiale-Alenia/de Havilland ([1])

(91/C 314/07)

1. A majority of the Committee agrees with the conclusion in the Commission's draft decision that the proposed concentration would be incompatible with the common market. A majority considers that a distinct market for 20 to 70 seat turboprop aircraft exists, within which are three segments, and that within these markets the proposed concentration would create a dominant position. It considers it is probable that there will be no market entry sufficient to provide realistic potential competition to the dominant position which the concentration will create. The concentration itself would further reduce the likelihood of new entry.

2. A minority does not accept the Commission description and analysis of the market. The Commission has chosen a methodology that gives the highest market shares possible to the parties. They consider that not only is the Commission's approach to statistical analysis of the market flawed but the Commission has underestimated the strength of competitors and customers in the market, exaggerated the real strength of DHC, ignored the history of competition in the market and the potential for new entrants. Further, this minority considers that the Commission is not so much protecting competition but rather protecting the competitors of the parties to this proposed concentration.

3. The Committee recommends the publication of this opinion.

([1]) OJ No L 334, 5. 12. 1991.

II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 28 April 1992

declaring the compatibility with the common market of a concentration

(Case No IV/M. 126 — Accor/Wagons-Lits)

Council Regulation (EEC) No 4064/89

(Only the French text is authentic)

(92/385/EEC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings (1), and in particular Article 8 (2) thereof,

Having regard to the Commission's Decision of 16 December 1991 to initiate proceedings in this case,

Having given the undertakings concerned the opportunity to make known their views on the objections raised by the Commission,

Having regard to the opinion of the Advisory Committee on Concentrations given on 26 March 1992 (2),

Whereas:

I. NATURE OF THE PROCEEDINGS

(1) These proceedings relate to a concentration which was notified to the Commission pursuant to Article 4 of Regulation (EEC) No 4064/89 ('the Regulation'). The notification came into effect on 15 November 1991. The concentration involves the proposed acquisition by Accor SA ('Accor'), through the intermediary of the holding company Cobefin, of all the shares still in circulation of the Compagnie Internationale des Wagons-lits et du Tourisme (CIWLT) by means of a takeover bid preceded by the acquisition of the majority of Cobefin's capital.

II. THE PARTIES

(2) Accor is a French catering and hotel group. Its main activities are catering (particularly on motorways), group catering, luncheon vouchers, hotels (including salt-water cures), certain tourism activities (cruises, tour operators, etc.) and certain related services.

(3) CIWLT is a Belgian catering, hotel and tourism group. Its main activities are catering (particularly on motorways and on trains), group catering, hotels (including railway sleeping-cars), car hire and travel agencies.

(1) OJ No L 395, 30. 12. 1989, p. 1, amended: OJ No L 257, 21. 9. 1990, p. 13.
(2) OJ No C 184, 21. 7. 1992, p. 2.

III. THE CONCENTRATION

(4) Following the takeover bid, which ended on 19 December 1991, Accor holds 69,5 % of the capital of CIWLT. Before the operation, Accor had only a minority holding in CIWLT. According to Accor, its minority holding did not allow it to exercise any control over CIWLT. However, the Brussels Commercial Court, in a judgment delivered on 4 December 1991, against which Accor has appealed and which does not bind the Commission, took the view that, prior to the operation, CIWLT was jointly controlled by a number of undertakings, including Accor. It is not necessary to determine whether Accor already exercised joint control over CIWLT before the operation. The Commission considers that even an operation whose object or effect was to enable an undertaking which exercised over another undertaking joint control within the meaning of the second subparagraph of Article 3 (2) of the Regulation to control such undertaking on its own is a concentration within the meaning of Article 3 (1) (b) of the Regulation. The operation is thus a concentration within the meaning of Article 3 (1) (b) of the Regulation.

IV. COMMUNITY DIMENSION

(5) The turnover of the last financial year known [1] as shown in the consolidated profit and loss account of each of the undertakings concerned is as follows:

Accor:	ECU 1 992 511 122 [2],
CIWLT:	ECU 2 332 250 499 [3].

(6) Accor has proposed adding to the sum of these two turnover figures, pursuant to Article 5 of the Regulation, the turnover achieved by operations of minority subsidiaries managed by Accor or one of its subsidiaries, under hotel management contracts in which Accor operates a hotel in the name and for the account of the minority subsidiary. Such companies are not included in the consolidated accounts. The Commission has noted that such contracts have the following characteristics:

— Accor runs the hotel under one of the group's established names and undertakes its management. Its terms of reference are general in scope, and it looks after the operation of the hotel, marketing, sales, accounting and financial management, management control, and legal, administrative and tax matters. The owner has the option of entrusting it with other services as well,

— Accor has full control of staffing policy: it recruits, manages, dismisses and supervises staff. It plays an important role in training. Only the negotiation of collective agreements and the secondment of members of Accor's staff to the hotel require the explicit agreement of the owner,

— the contract is long term (10 years on average, with renewal often tacit),

— if the owner sells, leases or otherwise disposes of the hotel, the buyer or new lessee must undertake to comply with an assume all the obligations incumbent on the owner *vis-à-vis* Accor. However, Accor may refuse the transaction and purchase or lease the hotel at the same price or rent and on the same terms and conditions as those set out in the owner's notification. If the buyer or new occupant refuses to assume the obligations incumbent on the owner and if Accor does not wish to purchase or lease the hotel, the contract will be terminated, and Accor will receive [...] [4] compensation.

In conclusion, it appears that the contract allows the owner virtually only the role of providing capital and confers on Accor the role of fully fledged manager. It follows that Accor has the right to manage the relevant undertakings' affairs within the meaning of the fourth indent of Article 5 (4) (b) of the Regulation. This conclusion is based on a detailed analysis of the contract, notably as regards the precise powers of the owner on budgetary matters, an analysis which has allowed the Commission to accept Accor's argument. The turnover generated by the contracts concerned is ECU 495 232 730.

(7) Account should also be taken of the item 'other operating proceeds' included in CIWLT's profit and loss account. The Commission considers that the components [5] of this item derive from the sale of products and the provision of services by CIWLT and are part of its ordinary activities.

This item amounts to ECU 422 436 636.

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(1) 1990.
(2) The ECU/FF conversion rate used is ECU 1 = FF 6,91412 (average rate for 1990).
(3) The ECU/BFR conversion rate used is ECU 1 = BFR 42,4257 (average rate for 1990).

(4) Substantial
In the published version of the Decision, some information has hereinafter been omitted, pursuant to the provisions of Article 17 (2) of Regulation (EEC) No 4064/89.
(5) Including proceeds from the sale of used cars by Europcar and volume discounts granted to Europcar by manufacturers on its purchases.

(8) The total of the amounts shown in recitals 5, 6 and 7 above represents the aggregate turnover of the relevant undertakings within the meaning of Article 5 of the Regulation and amounts to some ECU 5 240 000 000. The combined aggregate worldwide turnover of all the undertakings concerned is thus more than ECU 5 billion.

(9) Accor, like CIWLT, has a Community-wide turnover of more than ECU 250 million.

(10) The parties concerned do not achieve more than two-thirds of their turnover within one and the same Member State.

(11) Consequently, the concentration has a Community dimension within the meaning of Article 1 (2) of the Regulation.

V. ASSESSMENT PURSUANT TO ARTICLE 2 OF THE REGULATION

(12) The Commission has examined the tour operator and travel agency, group catering, hotel and commercial catering sectors in which the concentration will lead to an increase in Accor's market share. The vertical and conglomerate relationships that will emerge from the concentration have been taken into account in the analysis of the hotel sector.

A. The tour operator and travel agency sector

(13) In the tour operator and travel agency sector, the activities of Accor and CIWLT are marginal and they occupy at present a very modest place in the market. Consequently, the Commission has not included these two markets in its decision to open proceedings pursuant to Article 6 (1) (c) of the Regulation. The Commission has no objections concerning the effects of the concentration in these sectors.

B. The group catering sector

(14) In the group catering sector, the concentration will bring about an increase in market shares for the new entity only in Germany and Spain.

(15) (a) *The relevant product market*

The relevant product market is the market for contract group catering. By contract group catering the Commission means the provision of catering services outside the home performed by third parties and including principally the provision of prepared, or partly prepared, meals on the premises of public or private sector bodies:

— the provision of such services is carried out in various sectors, including catering at places of work (firms, administrative offices), in the social welfare and health sector (hospitals, old people's homes) and in education (schools, colleges). The Commission agrees with the view taken by Accor and most of the competitors questioned that there are no significant differences between these segments or between the public and private sectors that indicate the existence of distinct markets. The basic know-how is the same, and the majority of the undertakings concerned are engaged in all the above market segments. It may thus be considered that the group catering market as a whole constitutes the relevant product market,

— contrary to Accor's opinion, the relevant market does not include group catering carried out by bodies themselves (direct group catering). The running of a canteen by a firm or an administrative body is not a service offered on the market for the supply of catering services. It does not represent an alternative for customers seeking group catering provided by a third party. This view is in line with the Commission's consistent practice [8].

(16) (b) *The relevant geographic market*

Although there are signs of a tendency for the markets to open up, various features point to the conclusion that the group catering market must be regarded as still being national in character:

— the legislative provisions differ from one Member State to another, notably as regards the awarding of contracts in the public sector and as regards social welfare aspects,

— the preferences of client firms are not the same as between Member States with regard to quality of service, charging method, prices, etc.,

— the proportion of contract and in-house group catering and the extent to which group catering is not provided at all differ widely from one Member State to another.

(17) (c) *Compatibility with the common market*

1. The group catering market in Germany

The supply structure in group catering in Germany is characterized by a large number of small firms or independent contractors (Pächter) who offer their

(1) See in particular the Commission Decision of 23 September 1991 in Case IV/M. 134 (Mannesmann/Boge).

catering services at the regional or local level. Also present on the market are a restricted number of firms that are larger in terms of size and capacity (so called 'catering firms'), which often belong to a foreign group of companies (e.g. ARA, Sodexho, Gardner & Merchant).

The Commission has carried out an investigation among the eight most important German catering firms. As a result, it seems that services offered by the catering firms on the one hand and the small companies and independent contractors on the other hand are to a significant extent regarded as substitutable for the following reasons:

— a not inconsiderable part of the customers served by the catering firms is accounted for by bodies requiring an average number of 100 to 400 meals a day. This demand can be satisfied by the catering firms as well as by the small companies,

— the fact that the company supplying the services is represented 'on-the-spot' constitutes an important element in the choice of the customers. According to the information available to the Commission, there are only a few 'national contracts' according to which the catering firms supplies a catering service to all the companies belonging to the group on a national or European scale,

— finally the independent contractors who are more flexible in terms of price are in effective competition with the catering firms whose fixed cost structures are much higher.

In assessing the position which the new entity will acquire on the group catering market the question of whether the small firms and the independent contractors must be included in the relevant market or whether they form, on the contrary, a distinct market, may be left open. In either case, the Commission considers that the concentration is compatible with the common market.

(a) If the activities of the small companies and contractors are included, the value of the German contract group catering market may be estimated at ECU 1,2 billion. On such a market the new entity will have a market share of around 20 % which in itself does not indicate a dominant position.

(b) If one only takes into account the activities of the large catering firms, thus defining the market in a very restrictive way, the combined turnover of the nine leading catering firms amounts to some ECU 450 million [1]. On such a market the new entity will have a market share of about 51 %, followed by ARA (18 %), Sodexho (11,8 %), Pedus (7,3 %) and a number of firms having a smaller market share (PSG, Apetito, KSG, Gardner & Merchant and Zorn). On such a market, Accor will hold an important market position following the concentration not only in terms of absolute and relative market share, but also in terms of financial power and capacity. Despite this strengthening of Accor's market position, the Commission considers that an overall analysis of the conditions of competition determining the German catering market as required by Article 2 of the Regulation does not indicate that Accor will achieve a scope of action allowing it to behave to an appreciable extent independently of its competitors and its customers. This can be explained by the following reasons:

1. The contract catering market in Germany is still not very developed because of the traditional existence of in-house canteens, but it is growing quite rapidly. The majority of the catering firms consulted by the Commission forecast annual growth of 15 to 20 % in the years ahead;

2. There are no particular legal, technical or economic barriers that would hinder a new competitor from entering the market or that would restrain an actual competitor even of a smaller size from enlarging its activity in the market. On the one hand this has been confirmed by a majority of the catering companies upon inquiry by the Commission and on the other hand it has been demonstrated by the development of the German catering market itself, where a number of foreign companies have entered in the last years either by acquisition of a German company (Sodexho, Eirung & Ott) or by the creation of their own subsidiaries (Gardner & Merchant). These companies presently hold a significant position in the market as shown by the example of ARA and Sodexho who are the number two and number three of the catering firms in Germany;

3. Furthermore there are a number of competitors (ARA, Gardner & Merchant and Sodexho) present in the catering market, whose financial power is comparable to the financial power of the new entity and which have comparable activities in other Member States of the Community. On the other hand, financial power in itself does not seem to constitute a prerequisite for the success of a company in the market concerned. This is

(1) Source: information from catering firms and „Umsatzsteuerstatistik des Statistischen Bundesamtes" 1988.

shown by the existence of a number of medium-sized companies like Pedus, KSG or Apetito;

4. The competitive behaviour of Accor will in addition partially be influenced by the small companies and the independent contractors which represent a viable alternative for the customers on a regional or local level. There seem to be a large number of customers who take into consideration the companies represented 'on-the-spot' which are at the same time directly available and assure the regional characteristics in their supply. In the light of the existence of this local or regional demand Accor will be obliged to take into consideration the competitive reaction of the independent contractors or small companies. As a result, its scope of action in the market will be restricted;

5. Lastly, the negotiating strength of the catering firms will be limited by the fact that their clientèle is made up essentially of industrial firms, for which catering is only an auxiliary business.

   Since the contract group catering is a growing market, since there are no significant barriers to entry, since there are a number of competitors comparable in size and financial power, since there is some competitive influence resulting from the small companies and independent contractors who offer their catering services on a local or regional level, and since the industrial character of the clientèle affects the demand side, the high market share the new entity will achieve through the merger will not lead to a dominant position that would result in effective competition being impeded on the German group catering market.

2. The group catering market in Spain

The Spanish group catering market is comparable to the German market in that it is still not very developed, but growing rapidly. Its supply structure is characterized by the presence of a certain number of small companies with restricted geographic activity and some larger companies (catering firms) who account for about 90 % of the whole group catering market in Spain according to estimates of the industry.

If one only takes into consideration the activities of the large catering firms, the new entity will have a market share of 43 % according to the information available to the Commission. It will be followed by Sodexho (22 %), Husa (15 %), Serunión (10,8 %), Vasca (6,2 %) and Osesa (5,4 %). The concentration will therefore result in a high market share for the new entity in the Spanish market as well as in a strengthening of its financial power and improved access to the customers. Nevertheless, an overall analysis of the conditions of competition in the market shows that Accor will not acquire a dominant position following the concentration as a result of which effective competition would be significantly impeded in the Spanish market. This can be explained in particular by the following reasons:

1. The Spanish market for contract catering is a growing market. According to Accor the share that the contract catering firms in Spain presently hold in this market accounts for 7 % of total group catering including in-house group catering [1]. According to the GIRA-SIC study, the catering market in Spain has experienced annual growth of 10 % from 1980 to 1990. The catering firms present in the Spanish market and asked by the Commission have confirmed that they forecast comparable annual growth in the years ahead;

2. There are no specific legal, technical or economic barriers which would prevent a new competitor from entering the market or which would hinder an actual competitor, even of a small size, from developing its activities in the market. In addition, it is possible for a foreign competitor to enter the market either by acquiring a Spanish company already established in the market or by creating a joint venture with such a company. As to the expansion of actual competitors, the reasons explained under point 1 (b) 2 of this recital referring to the German market hold as well for the Spanish market;

3. Furthermore the supply structure of the group catering market is characterized by the existence of a number of competitors holding significant market shares. The presence of a number of medium-sized companies in terms of volume as well as financial power in the market shows that success in the market does not seem to depend on size or the financial power of the company;

4. Finally, the customers of the catering firms can turn without difficulty to small companies on a regional or local level. These small companies represent a viable alternative, particularly in terms of price, as a result of their greater flexibility and in terms of availability as a result of their local presence. This has been confirmed by the majority of the catering firms which were questioned on the Spanish market;

5. The Commission therefore considers that the concentration will not lead to a dominant position of the new entity as a result of which

(1) In terms of number of meals.

effective competition would be significantly impeded on the Spanish market for group catering.

(18) (d) *Conclusion*

The Commission has not included these markets in its decision to initiate proceedings under Article 6 (1) (c) of the Regulation. The Commission has no objections concerning the effects of the concentration in these markets.

C. **The hotel sector**

(a) *The decision to initiate proceeding*

(19) On 16 December 1991, the Commission decided to initiate proceedings pursuant to Article 6 (1) (c) of the Regulation including the hotel sector. The Decision was not followed by any communication pursuant to Article 18 of the Regulation, since the Commission took the view, after thorough investigations carried out as part of the proceedings, that it had no objections to the concentration in the hotel sector.

(b) *The market for hotel services supplied at local level*

(20) In its above mentioned Decision, the Commission stated that it had examined the effects of the concentration on the market for hotel services supplied at local level by hotels and establishments providing accommodation. Its examination had looked at the hotel sector both generally and separately by category. As regards this market, the Commission had concluded that the concentration did not raise any serious doubts as to its compatibility with the common market.

(c) *Study of hotel chains*

(21) Following its above mentioned Decision, the Commission carried out detailed investigations on hotel chains. The investigations prompted it to make the following observations:

— the industry distinguishes three broad categories of hotels [1]: independent hotels consisting of legally and economically independent undertakings (59 % of the total number of approved hotels, 47 % of rooms); voluntary chains consisting of groups of independent hotels which carry out their marketing, promotion, purchasing etc. under one and the same hotel name (32 % of the total number of approved hotels and 23,7 % of rooms); integrated chains which operate hotels directly through subsidiaries or indirectly by a franchise or management contract (9 % of the total number of approved hotels and 25,6 % of the total number of rooms),

— as regards supply, chain hotels differ in certain respects from independent hotels:

— chain hotels are based on a network concept involving a large number of establishments, which, as a result of broad geographical coverage meet service requirements that go beyond the purely local framework,

— from the point of view of the product and service supplied, the chain hotel offers a more uniform product from one hotel to another and a more extensive range of services (more extended opening hours, restaurant, reservation network, etc.),

— chain hotels are also based on a policy of operating under a common hotel name and trade mark, a policy which combines the marketing and commercial activities of the various hotels and allows them to become better known to the public at large by means that are inaccessible to a single independent hotel, because of their financial cost. Chain hotels also have their own centralized reservation systems (for example, Resinter for Accor, Holidex for Holiday Inn) or access to international reservation systems (for example, Amadeus, Galileo),

— hotel chains pursue a policy of actively seeking out customers. They approach intermediaries such as tour operators, travel agencies, airlines, computerized reservation systems and major companies. They offer them contracts which provide for special prices, promotional packages and access to related services such as car hire, the aim being to boost their network's clientèle.

Through such a joint policy, chains create aggregate demand, with the performance of one hotel benefiting the other hotels in the same network. Conversely, the number of overnight stays at an independent hotel established in only one site and whose name does not have the familiarity created by a network is entirely dependent on local competition and the habitual frequency of visits by its guests,

— as regards demand:

There are large customers, tour operators, travel agencies and large firms which work primarily with this type of hotel. The transaction cost of

[1] Study report by the national group of hotel chains 'les chaînes hôtelières en France'.

reservations is lower once it forms part of a pre-negotiated framework. Reservations are then made on the basis of pre-arranged formulae and framework agreements governing invoiced prices, terms of payment, commissions and discounts.

The investigations carried out have shown that at least two-thirds of the turnover of integrated chains derives from sales through travel agencies, Tour operators or customers covered by a framework contract.

Lastly, thanks to computerized reservation systems and tour operators, hotel chains have preferential access to international customers.

In the hotel trade, Accor and CIWLT operate mainly the following chains in France: Formule 1, Ibis, Urbis, Novotel, Mercure, Sofitel in the case of Accor; Arcade, Altea and Pullmann in the case of CIWLT.

Accor takes the view that hotel chains do not constitute a distinct market that is separate from the hotel trade as a whole. It is not necessary to determine, within the framework of this Decision, whether the hotel chain market must be regarded as distinct from independent hotels. Similarly, it is not necessary to determine the geographical framework within which competition operates.

The reason for this is that, even taking the narrowest market definition, which would be that of a national hotel chain market, the concentration would result in Accor/CIWLT holding, on the French hotel chain market, a market share of 18,7 % in terms of turnover and 25 % in terms of capacity (on the basis of the number of rooms). Of course, these market shares must be viewed in the light of the fact that Accor is the market leader in France, that the group has extremely wide geographical coverage (hotels in about 200 towns outside the Paris region) and that it is represented in all hotel categories through the large number of hotel names under which it operates.

In addition, Accor will improve its access to customers through its acquisition of CIWLT's travel agency network and will broaden its range of services through the joint control which it will acquire over Europcar (car hire). However, in view of the points set out below, the market shares noted, which are moreover modest in themselves, suggest that the concentration will not give the new entity a dominant position:

— other competing hotel chains with considerable financial strength, such as the Société du Louvre, Holiday Inn (Bass Plc group), Trust House/Forte, Hilton/Ladbroke, and Marriott operate on the market,

— the French hotel industry is continuing to develop, notably through the establishment of new chain hotels and through the modernization of independent hotels, facilitated by incentives and support measures made available by the public authorities,

— the increasing grouping together of independent hotels into voluntary chains is helping to increase the supply of hotel networks and is giving agencies, tour operators and large customers alternative sources of supply. In addition, independent computerized hotel reservation systems are being developed and increased,

— lastly, tour operators and travel agencies have, because of the volume of their business, considerable negotiating power which the chains must take into account. Tour operators and travel agencies provide services other than hotel services (transport, car hire etc.) which may involve a specific clientèle.

(d) *Conclusion*

(22) The Commission therefore considers that the concentration does not create or reinforce a dominant position that would result in effective competition being significantly impeded on the hotel market in the common market or a substantial part thereof.

D. **The motorway catering sector**

On the commercial catering side, only motorway catering is involved. Moreover, in this sector, it is only in France that the concentration will result in an increase in the market share of the new entity.

(a) *The decision to initiate proceedings*

(23) On 16 December 1991, after having examined the notification, the Commission decided to initiate proceedings pursuant to Article 6 (1) (c) of the Regulation, in particular because it had serious doubts as to the compatibility of the concentration with the common market in the motorway catering sector in France.

(b) *Communication pursuant to Article 18 of the Regulation*

(24) Following the investigations carried out in respect of a broad range of undertakings and associations, the

Commission sent Accor, on 29 January 1992, and CIWLT, on 7 February 1992, a communication pursuant to Article 18 of the Regulation.

(25) The objections raised in the communication may be summarized as follows:

1. the motorway catering market in France is a market that is distinct from traditional catering. This is due, as fas as demand is concerned, to the fact that the clientèle is specific (only motorway users can have access to such a service) and captive (the majoritiy of users do not leave the motorway when they wish to have a meal). As far as supply is concerned, motorway catering is characterized by very wide variations in turnover depending on the days of the year, the very great importance of the related services supplied to customers, the need to remain open seven days a week and to have very long opening hours, and a particularly strict legal framework notably because of the obligations imposed by the government;

2. a distinction must be drawn between three product markets within motorway catering. These are catering in the strict sense (with waiter service or self-service), light meals (snacks and sandwich bars) and sales of food products (through shops, vending machines, picnic facilities and take-aways). This distinction is based, as far as demand is concerned, on five criteria (time required for consumption, nature of the service provided, price, place of consumption and whether the journey is for business or pleasure) and, as far as supply is concerned, on five other criteria (nature of the firms for each type of service, presence of several types of catering at one and the same services area, perception of Accor's competitors, clauses contained in the contract documents, and amount of investment);

3. the relevant geographic market is the French market. Competition takes place essentially at the time when the catering facilities are being established, i.e. at the time of tendering for the right to operate the facilities. For legal and regulatory reasons, the conditions governing establishment, like the conditions governing operation, are uniform throughout the national territory. In addition, the differences between Member States in the organization of motorway networks and in the conditions governing establishment and operation of catering facilities mean that the market is not a Community market. This is confirmed by the fact that the major motorway catering firms operate in several Member States simultaneously to only a limited extent, that foreign firms (with the very particular exception of CIWLT) hardly operate at all in France and that attempts to establish operations on foreign metworks have generally been a failure;

4. the planned concentration would give the new entity a dominant position, with the result that effective competition would be impeded significantly on the markets for catering in the strict sense and for light meals, for the following reasons:

— the market share of the new entity would be 89 % for catering in the strict sense and 69 % for light meals,

— in catering in the strict sense, the new entity would be 18 times the size of its nearest competitor; as regards light meals, a very large number of competitors would share 31 % of the market,

— the market share does not seem likely to diminish appreciably in the near future, notably because of the number of service areas available and the period covered by subconcessions,

— in catering in the strict sense, the only competitors of the new entity would be a small group — Elitair — whose market share is 5 %, and independent caterers; as regards light meals, the only competitors would be fuel distributing companies, whose competitive strength in this sphere is limited,

— the financial strength of the new entity would be out of all proportion to that of its competitors,

— barriers to market entry are very high. They are due to legal and regulatory constraints (no freedom of establishment, long duration of concessions, heavy burden of administrative obligations for small firms), to the fact that motorways are limited in number and that the future development of the network is uncertain, and to the difficulty for foreign firms to penetrate the market,

— the new entity would see its procurement power increased, would benefit more than in the past from the advantage of operating successive service areas along given stretches of motorway and would have a more diversified image in the eyes of the companies operating the motorways in France,

— it is not certain that there would be any improvement in technical and economic progress to the benefit of the consumer. Even if this were the case, The Commission considers that there are other possible means of achieving it. At all events, the major obstacle to competition which the concentration would represent on the two markets of catering in the strict sense and light meals would not allow the Commission to alter its conclusion that the new entity would have a dominant position that would impede significantly competition on the relevant markets;

5. if motorway catering were to be regarded as a single product market, which the Commission disputes, the position would not be altered in substance. Even assuming such a market definition, the market share of the new entity is 58 %, and the other points set out in (4) above apply in a similar way. There would thus also be a dominant position resulting in effective competition being impeded significantly on the French market.

(c) *The reply made by Accor and CIWLT to the communication*

(26) Accor's observations on the Commission's communication were set out in a letter dated 12 February 1992. The objectives of Accor may be classified into two categories: those by which Accor questions the product markets as defined by the Commission, and those by which it contests the view that the concentration would create a dominant position. The Commission's response to Accor's observations in these respects are as follows:

1. Objections relating to market definition

(a) Accor considers that the figure of 5 % of motorway users that leave the motorway in order to make their purchases appears to be under-estimated. In this respect, the Commission can only repeat that the 5 % figure was indicated by 5 motorway companies (out of 7 that were questioned), and appears to correspond to reality. The Commission notes that Accor provides no evidence capable of raising doubts in this respect.

(b) Accor regrets that the Commission has not indicated that the type of meal chosen depends on the distance of the clients' journey. In this respect, the Commission does not know if this criterion is relevant, because none of the third parties questioned raised the issue. If this is the case, Accor's observation reinforces the fact that there really are three relevant product markets.

(c) Accor indicates that sales of light meals are increasing. The Commission does not contest this fact, but remarks that this evolution may equally be reflected in a reduction of sales in shops or of consumption of products purchased before the journey and outside the motorway, as in a reduction of restaurant purchases *stricto sensu*.

(d) Accor notes an increase in the market shares of the petrol retailers compared to the stagnation of motorway restaurant companies. In this respect, it is relevant to recall that petrol retailers are not present on the market for catering in the strict sense, which puts this argument into perspective.

(e) Accor considers that the presence of different service providers on the same service station and the configuration of such service stations facilitates the substitutability between these services. The Commission maintains that the presence of different services on the same service station demonstrates that the requirements of consumers vary. Furthermore, the Commission considers that the importance given by Accor to the second criteria is exaggerated in particular because the consumer is informed by specific motorway signalling (graphic representations).

(f) Accor considers that the existence of ancillary services common to the three service sectors and the presence of tables in proximity to automatic vending machines indicates substitutability. The Commission notes that the existence of these ancillary services does not in itself put into doubt the distinction to be made between the three product markets resulting from the combination of a number of relevant factors operating at the level of both supply and demand. Furthermore, the second argument put forward which does not correspond to common practice, would not in any event justify an inclusion of catering in the strict sense, even if it would permit the grouping of light meals and the retailing of food-stuffs.

(g) Accor considers that the price variation between the different services is in fact lower than that indicated by its competitors. In this respect, the Commission notes that Accor admits the existence of a price variation. The Commission notes, however, that in this respect, the price variation indicated Accor is largely based on the average price of purchases when calculated on a basket of goods, thus ignoring the price difference between individual products.

2. Objections in relation to the creation of a dominant position

(a) Accor reproaches the Commission for not having taken account of the development plans of the motorway companies. The Commission notes, however, that in relation to the development plans in question, Accor changed its position since the notification (see page 191) and mentions no precise details of the said development plans. Furthermore, the motorway companies evisage approximately 30 new installations in the following five years, a low annual increment (4 %) which does not bring into doubt the Commission's analysis.

(b) Accor considers that the service station shops have financial resources available that are comparable to those of Accor and CIWLT because they belong to the major petroleum companies. The Commission notes however that contrary to the partners of CIWLT installations, the manager of a service station shop is financially independent in this respect and has no recourse to the support of a group.

(c) Accor cites certain motorway restaurant companies that have a financial power comparable to its own. The Commission can only remark that none of these groups are, or have ever been, present on the French motorway network.

(d) Accor notes that the companies already present on the market must resubmit bids for new tender offers. The Commission recognizes this and recalls however that the remaining duration of most of the sub-concessions is long (at least 10 years).

(e) Accor considers that small undertakings may establish themselves notably through partnership, and notes a growing tendency in this respect. The Commission considers that the existence of partnerships demonstrates that it is difficult for a small undertaking to set up alone. The market share of these small catering companies is in this respect negligible (5 %).

(f) Accor argues that the concentration will enable training of personnel to be improved and certain installations to be modernized. The Commission observes firstly that the increases in productivity claimed by Accor remain vague, and have not been evaluated. Secondly, supposing that these benefits exist, nothing demonstrates that they will be superior to the running costs created by the larger size of the new entity. Finally, on the motorway restaurant market which has a weak elastic demand structure, the new undertaking with the dominant position that it will hold will have no interest to pass any assumed gains on to the consumer.

It therefore follows that Accor's observations do not fundamentally alter the conclusions contained in the Commission's communication. After making its observations Accor has, nonetheless, given a certain number of undertakings which are set out under heading VI.

(27) By letter dated 18 February 1992, CIWLT commented on the Commission's communication. CIWLT's comments may be summarized as follows. The Commission's reply is given in response to each comment:

1. CIWLT considers that the geographical reference market, motorway catering, will soon become a Community-wide market. It bases this view on the proposal for a Council Directive coordinating procedures for the award of public service contracts. The Directive will be applicable to motorway catering. The Commission is not unaware of the existence of the proposal and does of course consider that it must take account of such factors when, within the framework of merger control, it has to determine the geographical size of a reference market. However, it maintains that, in the case in question, the reference market is the French market and that there is no reason to think that this will change in the years ahead.

   As CIWLT points out, the Directive has reached the stage of a common position adopted on 25 February 1992 by the Council. *A fortiori*, it is not yet transposed into the national law of the Member States. The Directive will in principle not lay down any provisions on the granting of concessions. The procedures on the award of contracts and the rules governing operation are excluded from the Directive as regards the type of services concerned. In addition, the remaining period left to run for subconcessions (10 years and more) is such that the Directive could not have any impact until after a very long period. As for the number of invitations to tender anticipated for the new establishments in the years ahead, it is out of all proportion to the current number of establishments operated. The Commission therefore believes that the circumstances are completely different from Case IV/M. 102, TNT, cited by CIWLT;

2. CIWLT stresses the current features of its operations. Its establishments are operated in partnership with local caterers, chambers of

commerce or local authorities, which have a minority holding in the capital of the companies. It submits that such partnership, which confers rights on the minority partners, will mean that the Accor and Wagons-Lits networks will continue to be operated separately.

Internal competition between establishments belonging to one and the same group is not a sufficient argument for accepting a dominant position on the part of the group concerned [· · ·] (1). It is at any rate out of the question that Accor would refrain from intervening in the strategic decisions and/or management of CIWLT's operations. Consequently, CIWLT's argument is not relevant in the Commission's view.

It follows from the above that CIWLT's comments do not fundamentally alter the conclusions contained in the Commission's communication.

(d) *Comments of third parties*

(28) Three third parties submitted written comments to the Commission pursuant to Article 18 of the Regulation and Article 15 of Commission Regulation (EEC) No 2367/90 (2).

A motorway company wrote on 6 February 1992 to confirm its previous letters. In one of its previous letters, it had clearly stated that it was opposed to the concentration because of the obstacle to competition which would result.

An association of motorway companies stated, by letter dated 14 February 1992, that the concentration would not, in its view, jeopardize the balance between the two networks, provided that internal competition continued (through the maintenance of separate trade names) and that the system of lacal partnership was maintained.

A motorway company stated, by letter dated 7 February 1992, that it supported the position of the abovementioned association.

The points made by the latter two third parties have already been analysed by the Commission in point (2) of recital 27. They do not alter the conclusion contained in the Commission's communication.

(1) The possibility remains for Accor to change the existing internal structure of CIWLT.

(2) OJ No L 219, 14. 8. 1990, p. 5

VI. CHANGES MADE TO THE PLANNED CONCENTRATION

(29) However, Accor has informed the Commission by letter of 25 February 1992 its willingness to alter certain aspects of the concentration.

(30) It will undertake, within an agreed period, to sell off CIWLT's motorway catering activities. All of these motorway catering activities of CIWLT are directly or indirectly dependent on a subsidiary of CIWLT, Sogerba.

Accor's commitment relating to the transfer is accompanied by other commitments intended to make the transfer fully effective.

The undertaking given by Accor does not in any way prevent internal growth of its motorway catering activities.

VII. CONSEQUENCES OF THE SALE OF CIWLT'S MOTORWAY CATERING ACTIVITIES ON THE ANALYSIS UNDER THE COMPETITION RULES

(31) Accor's sale of CIWLT's motorway catering activities represents an important change in the facts of the case and has an influence on the assessment of the concentration on the French motorway catering market.

The sale would mean that Accor would not increase its share of the motorway catering market in France after the concentration. Consequently, the effects of the concentration outlined in the Commission's communication would not arise.

This change in the facts of the proposed concentration prompts the Commission to consider the concentration compatible with the common market, in the light of conditions and obligations within the meaning of the second subparagraph of Article 8 (2) of the Regulation which are the counterpart of the undertakings given by Accor. These conditions and obligations were sent for comment to CIWLT which replied to the Commission on 3 April 1992. On the one hand it disputed the right of Accor to give the sale undertaking because it considered that Accor did not own 100 % of the capital of CIWLT and that it was necessary to take into account the interests of minority shareholders. On the other hand, it requested the imposition of other conditions and obligations than those communicated by the Commission. On the first point it can be said that following the Commission's authorization the operation will allow Accor to exercise control over

CIWLT and thus to keep the undertaking given to the Commission. On the second point the Commission considers, after examination of the other conditions and obligations proposed by CIWLT, that they are not necessary either to authorize the concentration or to prevent serious harm to CIWLT.

HAS AOPPTED THIS DECISION:

Article 1

The concentration between Accor SA and the Compagnie Internationale des Wagons-Lits et du Tourisme is hereby declared compatible with the common market, subject to the obligation specified in Article 2 and the arrangements for implementing it specified in Article 3.

Article 2

Accor shall sell CIWLT's French motorway catering activities that are directly or indirectly dependent on Sogerba in one or more operations to one or more buyers within a given period.

Article 3

The obligation specified in Article 2 shall be subject to the following practical arrangements:

(a) no sale shall take place to natural or legal persons that would prevent the above mentioned sale from achieving its full effect (i.e. the removal of any link of any kind between Sogerba and Accor);

(b) as from the date of notification of this Decision until the date when the sale takes place:

— there shall be no transfer of activity from Sogerba to Accor,

— Accor shall ensure that the way in which the motorway catering activity dependent on Sogerba is operated commercially is not altered, and in particular that the trade names of the restaurants and sales outlets are not changed;

(c) Accor shall inform the Commission of the measures taken to comply with Article 2 above within six months of the date of notification of this Decision, and subsequently every six months; this obligation to furnish information will end at the date of the transfer, of which the Commission must be informed without delay;

(d) Accor means:

— the company Accor,

— any company controlled directly or indirectly by Accor or by a natural or legal person controlled directly or indirectly by Accor,

— any person acting on behalf of a company referred to in the two indents above;

(e) Sogerba means:

— the company Sogerba,

— any compnay controlled directly or indirectly by Sogerba or by a natural or legal person controlled directly or indirectly by Sogerba,

— any person acting on behalf of a company referred to in the two indents above.

Article 4

This Decision is addressed to:

Accor SA,
2, rue de la Mare-Neuve,
F-91000 Evry.

Done at Brussels, 28 April 1992,

For the Commission

Leon BRITTAN

Vice-President

II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 22 July 1992

relating to a proceeding under Council Regulation (EEC) No 4064/89 (Case No. IV/M. 190 — Nestlé/Perrier)

(Only the English text is authentic)

(92/553/EEC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings [1], and in particular Article 8 (2) thereof,

Having regard to the Commission decision of 25 March 1992 to initiate proceedings in this case,

Having given the undertakings concerned the opportunity to make known their views on the objections raised by the Commission,

Having regard to the opinion of the Advisory Committee on Concentrations [2],

Whereas:

I. BACKGROUND

(1) On 25 February 1992, Nestlé SA notified a public bid for 100 % of the shares of Source Perrier SA which was launched by Demilac, a jointly controlled subsidiary of Nestlé and Banque Indosuez. Nestlé has an option to purchase the shareholding of Banque Indosuez in Demilac, which it has announced it will take up. On 30 January 1992, Nestlé concluded an agreement with BSN following which the Volvic source of Perrier will be sold to BSN if Nestlé acquires control over Perrier.

(2) By decision dated 17 March 1992, the Commission continued the suspension of the concentration pursuant to Article 7 (2) of Council Regulation No 4064/89 (the Merger Regulation). Nestlé has acquired the majority of the shares in Perrier but is refrained from exercising the voting rights attached to these shares pursuant to Article 7 (3) of the Merger Regulation.

(3) By decision dated 25 March 1992, the Commission declared that the proposed concentration raised serious doubts as to its compatibility with the common market. The Commission therefore initiated proceedings in this case pursuant to Article 6 (1) (c) of the Merger Regulation.

II. CONCENTRATION AND COMMUNITY DIMENSION

(4) Nestlé has notified a public bid by which it intends to acquire control over Source Perrier SA and its subsidiaries (hereinafter referred to as 'Perrier'). The operation would thus lead to a concentration within

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(1) OJ No L 395, 30.12.1989, p. 1; corrected version: OJ No L257, 21.9.1990, p. 13.
(2) OJ No C 319, 5.12.1992, p. 3.

the meaning of Article 3 of the Merger Regulation. The undertakings concerned by the concentration, i.e. Perrier and Demilac, including the turnover of Nestlé, meet all the thresholds of Article 1 (2) of the Merger Regulation.

III. THE UNDERTAKINGS

NESTLÉ

(5) Nestlé is a publicly held Swiss company which is active in many sectors of nutrition. The Nestlé group manufactures and sells food products throughout the world. Nestlé has a consolidated worldwide turnover of more than ECU 28 000 million.

PERRIER

(6) Perrier is a French company which is mainly active in the manufacture and distribution of bottled waters. Perrier has also some activities in the cheese market. Perrier has a consolidated worldwide turnover of over ECU 2 000 million.

IV. AFFECTED MARKETS

(7) The proposed concentration between Nestlé and Perrier affects primarily the business of bottling water originating from a natural spring or source ('source water'). Source waters may be labelled as 'mineral water' provided they fulfil certain legal requirements regarding their composition and their quality, and provided they obtain an authorization from the competent authorities to that effect. Source waters which are not mineral waters will hereafter be referred to as 'spring waters'. The production and marketing of spring waters are also subject to an authorization from the competent authorities.

Nestlé's bottling activities in the source water sector are mainly located in France with the well-known brands Vittel and Hépar (turnover in 1991 : FF 1 564 million, with sales of 916 million litres) and in Germany (turnover in 1991 : DM 196 million with sales of 468 million litres). Perrier's bottling activities in the source water sector are mainly located in France with the wellknown brands Contrex, Volvic, Perrier, Saint-Yorre and Vichy (turnover in 1991 : FF 4,014 million with sales of 1,885 million litres). In France, Nestlé is almost exclusively active in the still mineral water segment while Perrier is present in both the still and sparkling mineral water segments. Both companies export water from their sources in France to other countries. The third major supplier on the French source water market is BSN. Sales of Nestlé, Perrier and BSN in the European Community are set out in Annex 1 ([1]).

RELEVANT PRODUCT MARKET

A. Distinction between bottled source waters and soft drinks

(8) Nestlé has submitted in its notification that there is no separate market for bottled source water, and that the relevant market to asses the proposed concentration should be that of non-alcoholic refreshment beverages, including both bottled source water and soft drinks. This market definition is argued on the basis that all beverages have as basic function to quench the consumer's thirst.

(9) The Commission considers that a limited substitutability in terms of functionality alone is not sufficient to establish substitutability in competition terms. In the present case, if the only criteria to establish substitutability was to be quenching thirst, many products of very different nature which fulfil that function would have to be considered as belonging to the same market (tea, milk, beer, certain fruits, etc.). Several factors, however, indicate the existence of a distinct market for bottled source waters, where operators are able to act with a significant independece of the actions of companies selling soft drinks, in particular in the area of pricing. These factors are examined below.

(a) *Demand considerations*

(i) Motivation of final consumers to purchase bottled water originating from a natural source

(10) Bottled source water, in particular in France, is bought and regularly consumed because of its image as a natural product (water originating from a natural source) and its association with purity, cleanliness, absence of contamination and, in general, health and a healthy style of life.

Several consumer surveys confirm this view. An example is provided by the survey carried out by the Institut français de démoscopie in October 1991 for Evian. It shows that the main reasons for which

([1]) Annex not published pursuant to the provisions of Article 17 (2) of Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets.

consumers drink still bottled water originating from a natural source relate to its positive action on the human body, in particular because of :

— elimination,

— provision of mineral salts,

and

— positive effect on health.

Other studies, where other types of questions were proposed to the comsumers, tend to confirm this view. The economic advisers of Nestlé themselves (see *Lexecon Report*) have submitted that: 'The clear evidence of consumer surveys in France is that many people drink bottled water mainly because they trust it to be clean, pure and free of contamination'. Furthermore, the market research study carried out by Sofres at the request of Nestlé's economic advisers has provided the following result: '... more importantly, the survey also asked people why they consumed bottled water in preference to ordinary tap water; and the most popular reason given was its *purity*, and this was followed by its *lack of a bad taste* and only on third place the *presence of minerals*' (Commission's emphasis).

In addition, the publicity campaigns of the three suppliers Nestlé, Perrier and BSN are all directed towards promoting these types of elements in the mind of consumers.

(ii) Differences in composition of the products, their taste and their intended use

(11) Soft drinks are normally manufactured with tap water, and contain additions of flavour and sugar and therefore have a different taste from source waters. Soft drinks are drunk in smaller quantities, not only to quench thirst, but also to satisfy a particular taste pleasure, often in a social context.

(12) Source waters are bought regularly by the final comsumer for daily use in large quantities to fulfil a basic alimentary need, whereas soft drinks are consumed more occasionally. The markets in terms of volumes demanded are very different; the levels of per capita consumption in France in 1990 were the following: bottled water 104,8 litres, carbonates, 29,9, still drinks 9,6, fruit juices 8,6 litres (Source Canadean report, Table 2.1.1). This significant difference in volumes shows that waters and soft drinks are demanded to fulfil largely different needs (low demand-side substitutability); it also shows that soft drinks do not constitute a sufficient substitution alternative for bottled source water.

(iii) Low responsiveness to price changes

(13) Three main factors indicate that it cannot be reasonably expected that an appreciable non-transitory increase in the price of source waters compared with that of soft drinks would lead to a significant shift of demand from source waters to soft drinks for reasons of price only.

1. *Substantial price difference in absolute terms between bottled water and soft drinks*

A comparison of manufacturer's ex-works price lists in 1991 shows the following price ranges (see Annexes 2 to 7 [1]):

— still spring waters (PVC bottles of 1,5 litres): between FF 0,85 and 1,4,

— still mineral waters (national brands in PVC bottles of 1,5 litres): between FF 2,49 and 2,56,

— sparkling mineral waters (national brands): between FF 2,99 and 3,47 (PVC bottles of 1,25 litres), FF 2,98 (PVC bottle of 1 litre) and FF 3,65 (glass bottle of 1 litre, non-returnable),

— soft drinks: FF 6,1 for Coca-Cola (PET bottle of 1,5 litres), between FF 6,1 and 9,4 for tonics (PET bottles of 1,5 litres), between FF 6,1 and 8,76 for still orange flavours (PET bottles of 1,5 litres).

Taking as a reference national still mineral waters, which account for the bulk of consumption in France (over 70 %), soft drinks are, at the manufacturer level, in the range of two to three times more expensive than source waters.

Retail prices (prices for the end comsumer) reflect this same gap. The Canadean Report, Nielsen and Secodip statistics provided by suppliers of source waters and soft drinks and information provided by the main food distributors all confirm this (see Annex 12 [2]).

Nestlé has denied the existence of such gap. Its representatives have submitted that: About 50 % of all soft drinks sold within France are colas. The normal consumer price per litre of Coca-Cola (non-returnable 1,5 litres PVC

(1) Annex not published pursuant to the provisions of Article 17 (2) of Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets.

(2) Annex not published pursuant to the provisions of Article 17 (2) of Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets.

bottle) is, FF 3,73, whereas the price per litre of Perrier (non-returnable glass bottle) is FF 4,10 and of Vittelloise flavour is even FF 5,23 (non returnable 1,5 litres PET).

Nestlé took these prices from the Canadean Report which indeed quotes a price for Coca-Cola of FF 3,73, applied in March 1991 by the retailer Casino. Nestlé's representatives have not given any explanation of why this price is the normal consumer price of Coca-Cola. The same Canadean Report also quotes much higher prices per litre of Coca-Cola (for instance, prices applied by Euromarché in the same period were FF 4,23 and even FF 4,83 for Coca-Cola Light).

In addition, whereas it seems plausible to select Coca-Cola (among the cheapest soft drinks) because it accounts for a large part of soft drinks consumption, Perrier or Vittelloise flavour are not indicative with regard to bottled source water. The brand Perrier, with 204 million litres sold in 1991 represents some 3,8 % of the bottled source water in France. All flavoured waters added represent less than 1 %. In addition, the packaging and pricing of these two products, which are positioned by the companies on the fringe between source water and soft drinks, is the exception rather than the norm in the bottled water market. Perrier and Vittelloise flavour cannot be considered either in terms of volume or marketing as representative of the source water market.

Moreover, Nestlé's price comparison adjusts for differences in volume in the respective bottles of Coca-Cola and Perrier, but it ignores the differences in the materials of those bottles. Perrier is sold in glass, which is more expensive than the plastic (PET) package of the Coca-Cola chosen to carry out the comparison. However, it is obvious that the price *per litre* of the same Coca-Cola sold in a glass bottle would be higher. In this respect, a comparison of prices as seen by consumers on the shelves in a retail store might therefore be more appropriate than adjusted retail prices. In this case, the price differences become even larger (see Annex 12).

In view of the above considerations, the Commission concludes that manufacturers' and retail prices of soft drinks, as a rule, are much higher (between 200 and 300 %) than those of bottled waters in France. A price-ratio between two and three is of such a magnitude that it cannot be reasonably expected that an appreciable, non-transitory increase in the price of source waters, would lead to a significant shift of demand from source waters to soft drinks for reasons of price only.

2. The market of bottled source water in France is characterized by strong marketing and promotional activities, with high advertising budgets for the three main suppliers. As a consequence of the resulting image of natural, pure and healthy product associated with source waters (see recital 10) consumers do not recognize soft drinks as a substitute of bottled source water for daily use at home. The general image directly associated by consumers with branded source water as a consequence of the common axes of the publicity of each brand, and their additional attachment to each particular brand reduce the importance of price as purchasing criteria (small elasticity of demand). Therefore, a small increase in the price of source waters is not likely to induce a reaction of consumers resulting in a significant substitution of bottled source water by soft drinks.

3. *Price evolution*

Manufacturers' prices of source water and soft drinks have had a very different evolution during the last five years (see recital 16). Suppliers of the national mineral waters have been able to substantially increase their prices in both nominal and real terms, in spite of the decreasing trend of soft drink prices during the same period. Manufacturers in both sectors do not seem to take into account in their pricing policies possible substitution by consumers of source waters by soft drinks. This price evolution seems to indicate that even strong and sustained reductions of soft drink prices in real terms would not force source water suppliers to also reduce their own prices, nor would it affect their ability to increase them.

(iv) Views of retailers

(14) The vast majority of retailers consulted by the Commission regard bottled source waters as a distinct market, where demand is basically led by brand awareness and health concerns. Furthermore, they regard mineral waters, in particular national brands, as products they need to offer to their customers in order to cover the full range of basic alimentary products. Because of the regularity of purchases of bottled water for household consumption and the high brand awareness of

consumers, retailers regard the national mineral waters as products they need to offer to their customers, with little or no possibility of substitution by other drinks. Retailers are therefore not likely to substitute source waters by soft drinks in response to changes in prices, since they need to sell both kinds of products.

(b) *Supply considerations*

(i) Conditions of production and marketing

(15) Production and marketing are subject to different constraints in the soft drink market and in the market of bottled source water in particular in France:

1. *Regulatory requirements*

the production of spring and mineral water is subject to authorisation (for mineral waters this can take between two and five years, see Goldman Sachs report, p. 16). Spring and mineral water has to be bottled at the source. Location of bottling plants is therefore subject to a major legal constraint which manufacturers of soft drinks do not have. Producers of soft drinks can locate their bottling plants according to an adequate balance between economies of scale and transport costs, a rationale water bottlers are not able to follow.

2. Manufacturers of soft drinks may and often do grant trade mark licences to independent bottlers who produce the soft drink in their own premises and sell the product under the original brand. According to industry sources, the soft drink industry has traditionally operated on the basis of national bottling/distribution franchises, although more and more the major companies tend to acquire controlling stakes in independent bottlers. In contrast, water from a given spring may only be bottled at the source. In addition, mineral waters (which represent over 75 % of the total French water market by volume), can only be marketed under the trade mark linked to their repective source, ie. mineral water extracted from a source has, by law, to be marketed under the trade mark registered for that source, and only water originating from that source can be marketed under that trade mark.

3. *Different actors in each market*

In France, no major soft drink producer (Cadbury Schweppes, Coca-Cola, Pernod Ricard) has been able to develop a presence in the market of bottled water, in spite of the past growth of demand and increasing manufacturers' prices for bottled source water. Similarly, the mineral water manufacturers do not have a major activity in the soft drink market (for instance, Perrier sold to Schweppes its Oasis still soft drinks in 1990, within an explicit strategy of focusing its business on the water market).

(ii) Manufacturers' pricing

(16) Pricing in the soft drink and the bottled source water market seems to follow a different logic, which further confirms underlying differences in the competitive constraints suppliers in each market face.

A comparison of manufacturers' list prices (ex-works, VAT and discounts excluded) for comparable packagings (PVC or PET plastic bottles of 1,5 litres) in the last five years permits certain conclusions to be made:

— prices of soft drinks in real terms, as deflated by the monthly French consumer price index, have shown a declining trend since 1987. The reduction in real prices of soft drinks contrasts with the evolution of real prices for mineral waters. All national mineral water brands have been able to substantially increase their real prices in the same period and gain at the same time sales in volume in the face of an expanding demand (see Annexes 2 to 7);

— the differences in pricing policies are further illustrated by an anlaysis of real price correlation. The coefficient of correlation of real prices among the different brands of waters ranges between a minimum of 0,85 (Badoit and Vittelloise) and 1 (Hépar and Vittel). Real price correlation among soft drinks marketed by different companies is often positive and relatively high (see for instance correlation coefficients between Coca-Cola, Indian Tonic (Schweppes) and Banga (Pernod Ricard)). However, correlation between each soft drink and bottled water is in most cases negative, or when positive, very low. Companies seem to acknowledge therefore in their pricing policies that the bottled water market and the soft drink market are subject to different competitive constraints.

It is particularly illustrative in this respect that BSN's Orange Passion is not significantly correlated with BSN's water brands, although it is the same company deciding on the pricing of both products.

(17) An examination of discounts granted on list prices by manufacturers does not alter the validity of these conclusions for the following reasons:

— list prices constitute, in particular in the source water market and in the soft drink market, an adequate indication of the pricing policies of the companies. The absolute level of discounts negotiated with each particular client (between [...] % [1] and [...] % in the source water market and between [...] % and [...] % in the soft drink market according to supplier and client) and their past evolution are not of such magnitude or variability that they would invalidate the representative value of list prices as indicators of the pricing policy of each company,

— a large portion of discounts cannot be considered as such in the sense that they cannot be passed on to final consumers, but rather as part of the publicity and promotional activities of the supplier or as purchase of a service from the distributor. Suppliers of mineral water include under the term discount budgets of varying amounts, linked for instance to the space allocated in retail stores for the suppliers products, to mailings to end consumers, promotional contests, etc.,

— from the point of view of the distributor, discounts are to a large extent compensated by transport costs, which are borne by the distributor himself. Transport costs are not the same for all distributors throughout France. However, since they have been estimated by Nestlé at roughly [...] % of the ex-works price for a distance of 300 km (page 16 of the notification), list prices constitute a fair approximation of the actual prices paid by distributors.

(iii) Supply side substitutability

(18) The conjunction of the production and marketing constraints described under recital 15 make it impossible for soft drink or beer producers to switch their installed capacity from production of soft drinks to production of source water, be it spring or mineral water. Even if soft drink producers currently had excess capacity, the legal requirement to bottle spring and mineral water at the source makes it impossible for them to use any possible spare capacity already installed to bottle source water.

Nestlé has suggested that bottlers of soft drinks and beer could use their bottling plants to produce purified tap water and enter the source water market with such a product. No evidence of the existence of soft drink or beer producers with excess capacity has been produced to support the submission.

Nestlé has further suggested that purified tap water is marketed in certain countries (United States of America, Denmark, Greece) and is starting to make inroads in Germany, where it accounts for 1,5 % of total consumption of bottled water. According to Nestlé, the fact that purified tap water is sold in certain countries constitutes sufficient evidence that it could be marketed in France, although it is not sold there at present.

Nestlé's submission rests on the implicit assumption that purified tap water would be considered by consumers as a substitute for source water. This assumption is not supported by any evidence. On the contrary, the characteristics of demand in the relevant geographic market indicate that this is not the case. Moreover, it is striking that in spite of:

— strong demand growth and the considerable rate of expansion of market volumes until 1990,

— constand price increases (after discounts) in the French market of bottled source water, in both nominal and real terms,

— the decreasing trend of list prices of the leading brands of soft drinks in real terms (in the case of Coca-Cola, even in nominal terms), which is further aggravated when discounts are taken into account,

and

— the technical and industrial ability of soft-drink or beer producers to bottle purified tap water,

[1] In the published version of the Decision, some information has hereinafter been omitted, pursuant to the provisions of Article 17 (2) of Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets.

no soft-drink or beer manufacturer has ever entered the source water market in France. Past evidence strongly suggests, therefore, that supply-side substitution has not been considered as commercially viable by the companies concerned.

In addition, the soft drink producers consulted by the Commission have confirmed that they do not currently envisage producing purified tap water for the French market, nor did they suggest it either to be commercially feasible or rational. In this respect, it has to be noted that Coca-Cola has fulfilled its needs for canned water for its vending machines in France with supplies of mineral water from Spa. It has not decided to use its own purified tap water (Bonaqa) sold in Germany, or to use its available installations in France to produce purified tap water.

For these reasons, considerations of supply-side substitutability cannot lead in the present case to a different view of the relevant product market.

(c) *Conclusion*

(19) It can be concluded that the relevant product market is that of bottled source water

B. Distinction between still source waters and sparkling and flavoured waters

(20) The assessment of the proposed merger would not be materially different whether sparkling and flavoured source waters are excluded form the relevnt product market or not. Several demand factors indicate that sparkling and flavoured waters could be excluded from the relevant product market. There are a number of differences between still source waters and sparkling and flavoured waters, in terms of physical characteristics, taste, intended use, volumes consumed and price levels. In certain exceptional cases, the companies concerned position sparkling and flavoured waters closer to soft drinks in terms of packaging, marketing and price. The sparkling water Perrier (3,8 % of the market) and certain flavoured waters (less than 1 %) constitute examples of such exceptions.

However, it is not possible to exclude competitive interactions between sparkling flavoured and still source waters. Most companies marketing still source waters also market sparkling source waters, and to a lesser extent, flavoured source waters. A bottler of still source water can easily switch production to a sparkling or flavoured source water, at least from a technical point of view.

For these reasons, it might be difficult to justify a radical exclusion of sparkling and flavoured source water from the relevant product market. However, still sparkling and flavoured waters certainly constitute different categories of products, or segments, within the overall market of bottled source water. In the present case the assessment of the proposed merger would in any event not materially differ even if sparkling and flavoured waters were excluded.

RELEVANT GEOGRAPHIC MARKET

(21) In view of the structural elements set out below, and after examination of the competitive environment in the source water markets in the Community, the Commission has concluded that the relevant geographic market within which the power of the new entity has to be assessed is France. Several factors indicate that the parties to the concentration are and will be able to determine their competitive behaviour in France without suffering significant competitive constraints from outside France.

(22) Nestlé's representatives have argued that the level of exports to other areas should be taken into account in the market definition. According to Nestlé, price discrimination between France and the areas where it sells abroad is not possible, at least in relation to Belgium and certain German Länder. Therefore, its pricing in France would be restrained by the conditions prevailing in these other markets where Nestlé is present, although conditions of competition in these other markets are substantially different.

On this basis, and after an analysis of French exports of bottled source water to Belgium and Germany, Nestlé has submitted that the relevant geographic market should be extended to include Belgium and certain German Länder. It has argued that if excessive prices were to be applied in the French market, parallel imports into France would develop. The mere threat of parallel imports would jeopardize any dominant position in the French market according to Nestlé.

However, in view of the different competitive environment prevailing in each Member State, the practical impossibility of the development of parallel imports and the absence of Community competitors capable of overcoming the strong barriers to entry into the French market, the Commission concludes that the relevant geographic market is France.

A. Competitive environment in the Community

(23) The competitive environment in the bottled source water market is very heterogeneous throughout the Community. Demand presents different characteristics in each Member State, trade flows are negligible in terms of consumption and supply is highly fragmented in most Member States.

(24) Demand of a very different nature in the various Member States. In countries such as the UK, Ireland, Netherlands, Denmark and Portugal, demand for bottled source water is extremely low or non-existent (very low consumption per capita) and the market is in a stage of take-off.

In other Member States demand is basically for sparkling waters only, which account in Germany for 75 % of the market, in Italy for over 60 %, in Belgium for 34 %. In these Member States, per capita consumption of bottled water is close to the consumption of carbonated soft drinks, which shows to what extent patterns of consumption are different.

(25) Trade flows in the Community are of minor significance. Water is a low-value/high-volume product which in general cannot bear transport costs over long distances. The high impact of transport consts tends to regionalize the bulk of the market. Nestlé itself has estimated the impact of transport costs at 10 % for 300 km for the most expensive still waters. For glass, transport costs are over twice as much.

Imports into the countries surrounding France remain negligible in terms of consumption: they represent around 5 % in Germany, less than 1 % in Italy and Spain. Basically these are imports of the French mineral waters, who appeal to the higher segment of demand, willing to pay substantial premiums for a reputed brand offering the extra benefit of an international flair. Only in Belgium do imports attain a certain significance, because of the low degree of concentration of the supply and the relatively small size of the market. Cnsumption in Belgium represents around 10 % of French prodction in volume terms.

(26) Supply is highly fragmented in Germany, Italy, Spain and to a lesser extent Belgium, which are the only countries in the Community where the market development would allow the presence of a major player.

In Germany none of the leading companies (Ueberkinger group, Gerolsteiner, Blaue Quellen (Nestlé), Apollinaris) accounts for a market share exceeding 10 % each, even when all their respective sources and brands are added. Only a handful of brands have national status: Apollinaris (less than 6 % of the market) and Fachinger (representing 7 % of the market) and also Gerolsteiner and Hirschquelle might be considered as national brands.

In Italy springs are spread throughout the country and there are over 200 companies marketing bottled source water. The leading brand Ferrarelle (owned by BSN) represents just 10 % of the Italian market. The situation is similar in Spain, where the leading brand Font Vella is also owned by BSN and accounts for 18 % of the market. Apart from Grupo Vichy Catalan (12 % of the market) dozens of other small companies with total annual sales below 100 million litres per year supply the Spanish market (source: Alimarket).

In Belgium the two main producers Spadel and Chaudfontaine enjoy higher market shares basically because of the smaller size of the market. Spadel's total sales of bottled source water in Belgium amount to 256,3 million litres (27 % of the market) and Chaudfontaine's sales to 95 million litres (10 % of the market). None of them has any significant export activity to France, in spite of the advantageous location of their sources.

(27) The fragmentation of these other markets and the absence of major companies comparable to the French suppliers is explained by a number of factors. In Germany, almost all source water is sold in (usually returnable) glass bottles, which increases considerably the impact of transport costs. In Italy, glass accounts for almost half of the total market and the leading brands are normally supplied in glass.

Furthermore, distributors of bottled water in Italy, Germany and Spain are relatively fragmented. Unlike in France, nationwide food retailers are much less important in these Member States, which further hinders the possiblities of suppliers of bottled water in these Member States to develop a large national home base allowing them to envisage expansion in other markets. At present, exports from either Italy, Spain or Germany represent less than 1 % of their respective production. Everything indicates that the struggle of companies in these Member States to overcome their regional limits and achieve at least a national dimension will still continue in the foreseeable future.

B. French exports and the threat of parallel imports

(28) Bottled source water is a relatively inexpensive and bulky merchandise with a high impact of transport costs. It is not likely, even if margins would be high, that a parallel importer could move throughout the various Member States the large volumes required to earn significant revenue and profits. Moreover, it has to be noted that, as a rule, exports of the French mineral waters are carried out through subsidiaries of the main suppliers. For instance, all export activity of Vittel to Belgium and Germany is carried out through Vittel's subsidiaries in those countries (Société Vittel Import and Vittel Mineralwasser GmbH respectively). This arrangement allows for a certain degree of control of the water exported to these two countries.

Prices in Belgium and Germany (prices delivered to customers) are significantly higher than the ex-works prices in France. Nestlé has quoted FF 3,36 per bottle of Vittel (1,5 l PVC) in Belgium and FF 2,82 for the same bottle in Germany for April 1991 [1]. These prices have to be compared with an ex-works price in France of FF 2,39 at that date. The result of this comparison is that the price at which any hypothetical parallel importer could buy Vittel in Belgium or Germany is currently much higher than list prices charged by Vittel in France (40 and 18 % respectively). In addition to paying these higher prices, the hypothetical reexporter would incur the costs associated with:

— transport back to France,

— unpackaging the pallets, relabelling each bottle and repackaging them again,

— its own margin.

Discounts and rebates granted at the year end on the basis of volumes and sales progression and range discounts also allow the control of parallel imports into France. An independent parallel importer would not be in a position to benefit from these discounts. By their very nature, this sort of discounts enables different commercial conditions to be applied to individual customers, even within France.

In Germany, the packaging of source water is different from that in France. The typical packaging in the German source water market is glass bottles of 75 cl, which are not used in France. 89 % of all sales of bottled water in Germany are packaged in returnable glass, and the bulk of French exports to Germany is packaged in glass. Vittel's exports to Germany consist basically of glass bottles of 1,25 l and 1 l, which together represent [. . .] of their exports. Transport costs for glass are substantially higher than for plastic (according to Nestlé's estimates as much as 200 %). In addition, French retailers have confirmed that distribution of still source water in France in glass bottles would face several problems (consumers are used to purchase still source water in plastic bottles and distributors would incur higher costs in handling glass instead of plastic).

For these reasons, the Commission considers that the conditions prevailing in the source water market show that the parties' exports and the threat of parallel imports do not and will not constrain the parties' competitive behaviour in the relevant geographic market.

C. Barriers to entry isolating the French market

(29) In addition to the different competitive conditions prevailing in France on the one hand and the rest of the Community on the other hand, there are strong barriers to entry into the French market of bottled source water. These barriers (see recitals 30 to 34) in themselves clearly indicate that France constitutes a separate geographical market, where French suppliers are able to impose appreciable non-transitory price increases without suffering any external competitive constraint.

(30) *Absence of imports*

In spite of the absence of tariff and legal barriers to trade, imports of bottled source water into France

[1] Prices reported in national currencies (Belgian francs and German Marks) were converted in French francs with the average exchange rate in 1991.

are negligible (between 1 and 2 % of total French consumption) and show no increasing trent. This is easily explained by the market structure prevailing in other Member States. Imports from remote areas or imports of glass bottles are practically excluded for reasons of price. It is important to remember that mineral and spring waters have to be bottled at the source and therefore can be produced only at one specific location. To the extent that there might be foreign sources located near France their transport costs might be absorbed. However, even if that were to be the case, the absence of imports is also explained by several other factors.

(31) *Distribution logistics*

French mineral water producers generate large enough volumes to transport water by train in complete wagons. Their logistics and that of most of their main customers are adapted to this competitive type of transport. Even companies located near France (such as Spa) would suffer a transport cost disadvantage to export to France, since they would have to either transport by truck or develop the necessary logistics and generate sufficient volume to take advantage of transport by train.

(32) *Access to distribution*

The French market is a mature market in terms of the number of brands and range of products. According to industry sources, access to the French retail market with a new source water brand additional to the well-established national brands is difficult; only brands with an estabished name can reasonably expect to survive in the medium to long term, rendering entry into the market a high-risk strategy. In addition, water shelf space in retail stores is necessarily limited, and it might in certain cases prove difficult to replace an existing brand.

(33) *Advertising (sunk) costs*

The French water market is characteried by the predominance of brands. The combined advertising budget of the three national French suppliers — Nestlé, Perrier and BSN — amounted to over FF 680 million in 1991. Heavy advertising by the three established suppliers has existed for several years. The establishment of a new brand would require heavy investment and could take a long time. In addition, the multiplicity of existing brands makes the establishment of a new one mor difficult (access to the media at the appropiate moment) and involves a high level of risk, in particular in view of the national image attached to brands belonging to Nestlé, Perrier and BNS.

(34) *Additional barriers to entry*

The high degree of concentration in the French source water market, with three companies holding 82 % of the market share by value, constitutes an additional barrier to entry and increases the risks associated with new entry (see recital 98).

The apparent failure of past attempts to enter the French market, together with the absence of imports confirms the actual economic impact of the barriers mentioned above. According to Perrier, there were 15 attempts at entry during the last five years. Only four are still present in the French market: Ferrarelle, which belongs to BSN, San Pellegrino, where Perrier holds a 20 % stake and has three of the nine members of the board of management, and Apollinaris and San Benedetto, which remain insignificant in terms of sales. According to food distributors' sources, while certain brands might enjoy an initial acceptance by the French consumer, consumers in general return to the well-known national brands in the short or medium term. The fact that the Belgian company Spadel directs its export effort to the UK rather than to France, in spite of the geographical situation of its source, further shows to the difficulties of penetrating the French market.

V. COMPATIBILITY WITH THE COMMON MARKET

(35) For the reasons set out above, the assessment of the compatibility of the proposed merger is made on the basis of a separate French market for bottled source waters (hereinafter referred to as 'bottled water') which is composed of still waters and sparkling waters. The focus of the assessment will mainly lie on the segment of still waters because this segment represents approximately 84 % of the total bottled-water market in volume terms and because not material change occurs in the segment of sparkling waters where Nestlé itself has only a small acitivity in flavoured sparkling waters.

(36) The smaller local waters (mineral and spring waters) are included in the market to be assessed, although they differ in a number of respects from the national

mineral waters. These differences will be set out below and taken into account in assessing whether local waters (mainly spring waters) provide a sufficient competitive constraint on the nationally distributed mineral waters.

(37) The assessment of the proposed merger will also take account of the agreement concluded between Nestlé and BSN on 30 January 1992 by which these two parties have agreed, subject to Nestlé acquiring control over Perrier, to transfer Volvic, one of the major still mineral source waters of Perrier, to BSN. In its assessment of the proposed merger, the Commission must take into account any existing agreement, the implementation of which would have an appreciable impact on the future market structure. Such an agreement, like any other market element, may lead to the conclusion that the take-over of Perrier under those future market conditions cannot be declared compatible with the common market. The assessment must be made for two situations, one where the Volvic agreement would be implemented and one where the parties would decide not to implement the Volvic agreement.

A. Market shares

(38) In its notification of the proposed merger, Nestlé has provided figures of the total market volume and the market shares of the respective market participants based on its own data and data collected by the Chambre syndicale des eaux minérales and the Chambre syndicale des eaux de source. Nestlé provided figures for the years 1986 to 1991. Nestlé also provided figures of the total market value and the market shares by value.

(39) According to these figures, in 1991 the total market value and the total market volume and the respective market shares of the three national water suppliers, ie. Nestlé, Perrier and BSN, and of the local water suppliers ('others') were as follows:

Value		Volume	Total (5 250 million l)		Still (4 394 million l)		Sparkling (856 million l)	
1991	FF 9 334 million	1991	all waters	only mineral	all waters	only mineral	all waters	only mineral
Nestlé	[. . .]	Nestlé	[. . .]	[. . .]	[. . .]	[. . .]	[. . .]	[. . .]
Perrier	[. . .]	Perrier	[. . .]	[. . .]	[. . .]	[. . .]	[. . .]	[. . .]
BSN	[. . .]	BSN	[. . .]	[. . .]	[. . .]	[. . .]	[. . .]	[. . .]
Total 3	82,3	Total 3	76,0	94,1	74,2	93,5	85,4	96,5
Others	17,7	Others	24,0	5,9	25,8	6,5	14,6	3,5

(40) The market shares in value terms better reflect the real market strength in this market than the market shares in volume because the French water market is composed of two categories of products which are very different in terms of price, ie. the nationally distributed mineral waters and the local waters, which are mainly spring waters. There exists a wide and constantly increasing price gap between these two categories of waters. On average, the manufacturers' ex-works price of local spring waters is about FF 1 per 1,5 l PVC bottle while the ex-works prices of national mineral waters currently range between FF 2,49 and 2,56 for the same quantities. After the deduction of a flat-rate rebate of 10 % the gap between national waters and local spring waters thus amounts to between FF 1,24 and 1,30. Given this considerable price difference between these two categories of waters and the importance of financial resources in the water market for investment in publicity and marketing, the Commission considers that it is more appropriate to take account of the market shares expressed in value than in volume. The market shares in value provided by Nestlé show that the three national suppliers hold a market share of 82,3 % of the total French bottled water market and that the local suppliers have a market share of only 17,7 %.

(41) In its written and oral submissons following the statement pursuant to Article 18 of the Merger Regulation, Nestlé changed the volume figures it had originally presented in the notification which were based on data from the two relevant trade associations in favour of figures taken from the Canadean Report 1990. According to that report the total market volume would not be 5,250 million but 5,900 million litres, the difference resulting mainly from the view that local suppliers would have a

larger share of the market, representing not 25,8 but 35,5 % for still waters. BSN which was also heard by the Commission presented estimates of two panels (Intercor and Secodip) which would suggest a higher market volume than that presented by Nestlé in its notification.

(42) Nestlé has not changed its figures on the total market value, ie. FF 9,334 million. BSN has suggested a total market value of FF 9,400 million. These figures are remarkably close and thus confirm the value figures provided by Nestlé on notification. Therefore, the discussion about the market volume is less important since in any event the market shares by value would remain at the level of 82 % for the three national suppliers and 17 to 18 % for the local water suppliers.

(43) As regards the market volume, the figures suggested by the Canadean Report 1990 and the Intercor/Secodip panels are only estimations which cannot be given more credit than the figures originally presented by Nestlé which are mainly based on data received from the relevant trade associations. The Canadean Report and the Intercor/Secodip panels include in the category of others local mineral and spring waters belonging to Nestlé and Perrier. In 1991, these waters represented a volume of 221 million litres. In addition, unlike the figures of the trade associations, these reports and panels are only estimations based on samples of part of the sales of retailers or purchases of consumers. Finally, they contradict themselves because they present three entirely different estimations of the total market volume, ie. Intercor 5 390 million, Canadean 5 900 million and Secodip 6 690 million litres.

(44) In 1991 the strong demand growth of 1989 and 1990 (mainly due to exceptionally hot weather conditions) was interrupted and slowed down to below 1 %. Nestlé's figures provided on notification take account of this interruption in demand growth and provide a total market volume for 1991 of 5 250 million litres. In Annex 2, the Commission sets out the sales volumes obtained through its enquiries and from the data of the relevant trade associations. This calculation leads to a total market volume of 5 249 million litres (still waters 4 419 million litres — sparkling waters 830 million litres). These figures are remarkably close to the figures provided by Nestlé in its notification.

The figures provided by the Chambre syndicale des eaux minérales and the Chambre syndicale des eaux de source show that in 1991 there was a decline in sales of local mineral waters compared to 1990 and only an increase of 3,3 % in sales for local spring waters. This confirms the general trend of the market in 1991 which only experienced a small increase in total volume compared to 1990.

(45) It can be concluded from the above that both the value and volume figures provided by Nestlé in its notification are reliable figures which can be used for the assessment of the proposed merger. These figures are also to a large extent confirmed by the share of local waters in the total water sales (still and sparkling) of a number of major retailers and wholesalers. A weighted average of those sales shows that the local water suppliers represent in volume only approximately 22 % of total water sales. By value, this share falls to approximately 16 to 17 %.

(46) From 1986 to 1991, the market shares for the total French water market by value and volume evolved according to Nestléy's own figures as follows:

	1986	1987	1988	1989	1990	1991	Average	Difference low/high share
by value								
Nestlé	[...]	[...]	[...]	[...]	[...]	[...]	[...]	2,4 %
Perrier	[...]	[...]	[...]	[...]	[...]	[...]	[...]	1,9 %
BSN	[...]	[...]	[...]	[...]	[...]	[...]	[...]	2,1 %
Others	[...]	[...]	[...]	[...]	[...]	[...]	[...]	2,3 %
by volume								
Nestlé	[...]	[...]	[...]	[...]	[...]	[...]	[...]	3,2 %
Perrier	[...]	[...]	[...]	[...]	[...]	[...]	[...]	1,4 %
BSN	[...]	[...]	[...]	[...]	[...]	[...]	[...]	2,6 %
Others	[...]	[...]	[...]	[...]	[...]	[...]	[...]	4,7 %

The above table shows that the market shares of the three national suppliers remained relatively stable over the period considered. The average variation in market shares for all three suppliers amounted to 2,1 % by value and 2,4 % by volume. This compares with a variation of the market shares of all others of 2,3 % by value and 4,7 % by volume. In absolute terms, the three national suppliers have constantly increased their sales in terms of value (average increase of 9,4 %) and in terms of volume (average increase of 4,6 %). It is only in 1991 (strong reduction in demand growth) that the three national suppliers lost a volume of 49 million litres (see recital 68) while still increasing their sales in value by 4,9 %. In the same year, the local mineral water suppliers also lost volume. Only the local spring water suppliers could increase their volume by 3,3 %.

Given the fact that demand growth is largely due to environmental reasons leading people to replace tap water by the cheapest bottled water which are spring waters (tap-water replacement segment), the above variations in market shares are relatively small. They do not indicate a fundamental change in the market positions of the three national suppliers amongst themselves or with regard to local water suppliers.

(47) Based on Nestlé's figures provided on notification, the post merger market shares in the still water segment with and without the sale of Volvic to BSN would be as follows:

Without sale of Volvic to BSN

Only still 1991	Value	Volume	
	all waters	all waters	only mineral
Nestlé	[. . .]	[. . .]	[. . .]
BSN	[. . .]	[. . .]	[. . .]
Total 2	82,4	74,2	93,5
Others	17,6	25,8	6,5

With sale of Volvic to BSN

Only still 1991	Value	Volume	
	all waters	all waters	only mineral
Nestlé	[. . .]	[. . .]	[. . .]
BSN	[. . .]	[. . .]	[. . .]
Total 2	82,4	74,2	93,5
Others	17,6	25,8	6,5

(48) It can be concluded from the above that the French bottled water market is already a highly concentrated market before the merger and that the merger would further increase this concentratin because only two suppliers would hold 82 % of the market by value and nearly 75 % by volume with over 90 % of all still mineral waters.

B. **Capacities and portfolio of sources**

(49) Nestlé has submitted that nearly all major sources of Nestlé, Perrier and BSN are working close to their maximum capacity and consequently cannot maintain their market share in a strongly growing market.

(50) Nestlé itself, however, recognizes that the growth rate of the French bottled water market is likely to slow down and indeed did not reach 1 % in 1991. Nestlé speaks of a realistic growth rate of 5 % over the next years.

(51) In the still water segment at the centre of discussion in this caŝe, Nestlé has the following free capacities in mineral water (ie. output capacity of the source per year):

1. Vittel
   - annual capacity: [. . .] million litres,
   - free capacity: [. . .] million litres,
2. Hépar:
   - annual capacity: [. . .] million litres,
   - free capacity: [. . .] million litres,
3. Abatilles:
   - annual capacity: [. . .] million litres,
   - free capacity: [. . .] million litres.

Nestlé also owns the spring water Pierval which has a capacity of [. . .] million litres and a free capacity of [...] million litres.

(52) *Perrier* owns two major still mineral water sources with considerable free capacities, i.e. Contrex and Volvic. The exact figures are known to the Commission but cannot be disclosed for reasons of trade secrecy. The free capacity of both sources combined exceeds the total still-water market volume. Perrier owns in addition other still mineral water sources, in particular Thonon which has an estimated capacity of [. . .] million litres and a free capacity of approximatively [. . .] million litres (Nestlé's estimation).

Perrier further owns a number of important sparkling mineral waters: Perrier, Saint-Yorre, Vichy and several smaller sources. The first two sources have a considerable overall and free capacity.

Finally, Perrier owns a large number of local spring water sources, in particular the sources Castel, Saint-Roch, Les Ormes, Carola, Saint-Lambert, Montegut, Regina and Sergentale.

(53) *BSN* has one major still mineral water source, ie. Evian, which has an estimated free capacity of approximately [...] million litres and one major sparkling mineral water source, i.e. Badoit which has reached its maximum capacity. BSN is presently developing a new sparkling mineral water source called Salvetat.

(54) After the merger and the sale of Volvic to BSN, the two suppliers would have a considerable numer of sources, the overall free capacity of which would by far exceed the total water market volume (5 250 million litres) and each one of these two suppliers would have at least one major still mineral water source with huge free capacities compared to the overall market volume and all other local water suppliers. They would thus be in a position to respond to an increase in demand without any capacity limitation, even if one were to assume a constant growth rate of demand of 5 % per year. Although it is not possible to mix mineral waters from different sources, Nestlé and BNS would considerably increase their respective portfolios of major and reputable sources and brands with the result that they can better adapt their marketing strategies to demand increases.

(55) None of the local water suppliers has water sources in number or in size similar to those of Nestlé and BSN after the merger. The capacities of most of the local sources are below 200 million litres and generally much lower than that. Even if different spring waters can be sold under one brand (e.g. a retail brand) they must still be bottled at the source with the result that, given their low price, they cannot be transported over longer distances 200 to 250 km). This means that if a big retail chain intends to develop a retail brand with several spring waters, it can only do so with waters coming from different sources and thus having different tastes and characteristics. These types of waters are at the lowest end of local spring waters and thus do not strongly compete with the national mineral waters which are known for their mineral characteristics, their stability in composition and their identical geographic origin. This fact is confirmed by most retailers (see Annex 15 ([1])).

(56) It can be concluded that after the merger and the sale of Volvic to BSN, both Nestlé and BSN would have very considerable capacity reserves and thus be able to respond to an increase in demand. The acquisition of Perrier and its subsequent division would considerably increase the overall and free capacities of both Nestlé and BSN.

C. Prices

(57) Even without the merger a narrow oligopoly of three suppliers exists between whom price competition is considerably weakened and for whom the degree of market transparency is very high.

(58) *Price gap between local spring waters and national mineral waters*

The ex-works prices (before rebates and VAT) of Nestlé, Perrier and BSN for their five major still mineral waters range currently between FF 2,49 and 2,56 per 1,5 l PVC bottle: Contrex FF 2,56, Hépar FF 2,55, Evian FF 2,51, Vittel FF 2,49 and Volvic FF 2,49. After the deduction of a flat-rate rebate of [. . .], these prices exceed the average ex-works prices of local spring waters by FF 1,24 to 1,30 per 1,5 l bottle (see recital 40).

(59) *Price increases and price parallelism*

The ex-works prices (before rebates and VAT) of the five major still mineral waters of the three national suppliers have constantly increased in a parallel way since at least 1987 (see Annexes 5 and 6). The average annual increase of prices between 1987 and 1992 was: Contrex 5,10 % (nominal) — 1,69 % (real); Volvic 4,83 % (nominal) — 2,10 % (real); Vittel 5,17 % (nominal) — 1,41 % (real); Hépar 5,70 % (nominal) — 1,60 % (real); Evian 5,82 % (nominal) — 2,29 % (real). Whoever first increased its prices was always followed by the other two suppliers. There was no price decrease during the

([1]) Annex not published pursuant to the provisions of Article 17 (2) of Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets.

whole period considered. The price leader seems always to have been Perrier which has traditionally maintained the highest price level for most of its products. The rebates granted by the three suppliers were according to the Commission's information, in the range of [. . .] to [. . .] %.

(60) *Elasticity of demand*

With regard to local waters (mainly spring waters), the cross-price elasticity of demand of the national still mineral waters is relatively low. The three national suppliers have created an extremely high consumer fidelity through long standing and strong publicity campaigns for national mineral waters. This is confirmed by the fact that retailers, who only reflect the demand of consumers, do not consider price as the first criterion for the choice of national mineral waters (see Annex 14 ([1])) and by the fact that they consider themselves dependent on the major national mineral water brands (see Annex 15). This low cross-price elasticity of demand with regard to local waters is clearly borne out by the fact that since at least 1986 the three national suppliers have maintained and constantly increased their absolute sales volumes (which represent over 70 % of the total water market) with only a small loss in 1991 when total demand growth slowed down considerably. There thus exists a low cross-price elasticity of demand for mineral waters which facilitates price increases or at least the maintenance of high prices without losing significant sales volumes to local water suppliers.

(61) *Production cost-price margin*

The production cost-price margin of the three national suppliers for a 1,5 l PVC national still mineral water bottle is very high: it varies between approximately FF [. . .] and [. . .]. The cost basis used includes variable and fixed production costs and advertising costs. From this very high production cost-price margin and from the important price difference with local spring waters which are priced at a competitive level it can be concluded that prices for national mineral waters are probably already at a very high, supra-competitive price level.

(62) *Market transparency*

The three national suppliers publish their list prices with the basic quantity rebates. Since they all supply the same customers, there is also a considerable feedback from these customers. In addition, the three suppliers provide the Chambre syndicale des eaux minérales with their monthly sales volumes and each one receives the monthly sales quantities broken down by brand of the other suppliers. In a narrow oligopoly such a practice further increases the market transparency and permits each supplier to follow the evolution of the market positions of the others.

D. Cost structures

(63) Nestlé recognizes that the major brands of the three national suppliers have similar cost structures (see *Lexecon Report,* p. 45). The manufacturing process consists basically of bottling. The need to bottle at source and the resulting multiplicity of bottling plants reduces the scope for economies of scale. As a result neither Nestlé nor BSN has a major cost advantage which could give either one of them an incentive for aggressive competitive action *vis-à-vis* the other. It must also be noted that the three national suppliers all apply a system of ex-works prices, transport costs being borne directly by the customers (retailers/wholesalers).

E. Competition from local water suppliers

(64) Nestlé, supported by BSN, has submitted that local waters (mainly spring waters) constitute a competitive constraint for the three national suppliers. In its written submissions to the Statement pursuant to Article 18, Nestlé claims that local suppliers represent 34 % (still waters: 35,5 %) of the French water market and that in certain hypermarkets their share would have reached 50 %.

(65) According to Nestlé's own figures, the market share of others by value amounted in 1991 to only 17,7 %. Given the considerable price gap between the average ex-works prices of local spring waters and national mineral waters, it is the market share by value which best reflects the market strength of local waters in the total water market (see recital 40). It is not disputed by Nestlé that in value terms, the sales of others are generally below 20 % of the total market.

(66) As regards the sales of others by *volume*, their market share in 1991 amounted according to Nestlé's figures to 24 % for the total water market and 25,8 % for the still water segment. These

([1]) Annex not published pursuant to the provisions of Article 17 (2) of Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets.

market shares are confirmed by the share of sales held by local waters in the total water sales of a representative sample of retailers and wholesalers for which the weighted average sales of local waters represents approximately 22 % of total water sales.

(67) The evolution of the market share of others in the total water market was as follows for the last five years; by value: 16 % in 1986, 17,7 % in 1991 (increase 1,7 %); by volume: 20,3 % in 1986, 24 % in 1991 (increase 3,7 %) (see recital 46).

The evolution in absolute figures of sales values and sales volumes (total waters and still waters) of the three national suppliers and the local suppliers (others) is set out in the following table:

Total waters by value (FF million)									
	1987	1988	1989	1990	1991	Total 1987 to 1991	Average 1987 to 1991	Total 1989 to 1991	Average 1989 to 1991
Nestlé/Perrier/BSN	+289	+520	+833	+781	+364	+2 787	+557	+1 978	+659
Others	+ 20	+ 90	+240	+200	+170	+ 720	+144	+ 610	+203
Total waters by volume (million litres)									
	1987	1988	1989	1990	1991	Total 1987 to 1991	Average 1987 to 1991	Total 1989 to 1991	Average 1989 to 1991
Nestlé/Perrier/BSN	+ 80	+186	+301	+285	− 49	+ 803	+160	+ 537	+179
Others	− 5	+ 19	+209	+125	+ 99	+ 447	+ 89	+ 433	+144
Still waters by volume (million litres)									
	1987	1988	1989	1990	1991	Total 1987 to 1991	Average 1987 to 1991	Total 1990 to 1991	Average 1990 to 1991
Nestlé/Perrier/BSN	n.a.	n.a.	n.a.	+261	− 47	n.a.	n.a.	+ 214	+107
Others	n.a.	n.a.	n.a.	+113	+ 90	n.a.	n.a.	+ 203	+101

(68) The above table shows that following two years of very strong growth mainly due to exceptionally hot weather conditions, market growth slowed down considerably from 8,5 % in 1990 to 0,9 % in 1991. In spite of this strong decline in demand growth, the market value increased in 1991 by FF 534 million, of which the three national suppliers took FF 364 million (68 %) and the others FF 170 million (32 %). During both the last five and three years, the average increase in value of the three national suppliers always exceeded by more than three times that of the local suppliers. They have constantly increased their turnover, even in 1991 when they lost 49 million litres in volume.

(69) The above table further shows that in volume terms the sales growth of not only the three national suppliers but also of the local suppliers declined in the years 1990 and 1991. In spite of a stronger decline of the three national suppliers in 1991, the average increase in sales of the three national suppliers during the last five and the last three years always exceeded that of the local suppliers.

(70) The volume losses of the three national suppliers in 1991 were small: 47 million litres for still waters and two million litres for sparkling waters. This represents only 1 % in the still water segment where the three suppliers together hold nearly 75 % of the market volume. Given the strong reduction in demand growth in 1991 following two exceptional years of growth, this loss is not the sign of a significant shift in demand in favour of the local spring waters. Also, the loss of sales of the national suppliers in 1991 is not necessarily or only due to competitive action of local spring waters because with a price increase of 7,11 % in 1991, Evian still gained a volume of 20 million litres. Volvic and Hépar, which also increased their prices, equally gained in volume, respectively 35 and 16 million litres. Only Contrex and Vittel lost in volume. Furthermore, it is not denied that a certain degree of competition exists between the national mineral

waters and local spring waters. However, the above changes are not sufficient to show that local spring waters constitute a real competitive threat to the market positons of the three national suppliers. Even lively competition is not incompatible with market power as long as such competition does not compel the undertakings holding the market power to lower their prices (see the Court's judgment in Hoffmann-La-Roche, paragraphs 70 and 71, 1979 [ECR] 461).

(71) It must always be kept in mind that the prices of national mineral waters are already at a very high level. In spite of this situation, the three national suppliers have succeeded in regularly increasing their prices and further increased their prices in 1992 (Contrex 3,64 %, Volvic 4,18 %, Vittel 4,18 %, Hépar 5,80 % and Evian 4,14 %). Thus, the three suppliers themselves consider that it is still profitable to increase their prices and that the pressure from local waters is not such as to prevent them either from maintaining the present high prices or even from increasing them. This ability constantly to increase prices, even in real terms, is a strong proof that competition from local water suppliers has not been sufficient in the past and is not likely after the merger to significantly contrain the market power of the three national suppliers.

(72) There exist a number of structural disadvantages for local spring water suppliers which limit their competitive pressure on the national suppliers.

The suppliers of spring waters are small companies which are dispersed numerically and geographically. None of the local suppliers achieves 10 % of the total market or of the still water market segment. In 1991, the family Papillaud and the group CGES each reached a sales volume representing a market share in the region of 8 to 9 % by volume and 3 to 4 % by value. Most of the other local water suppliers have market shares below 5 % by volume and much smaller by value.

(73) The local suppliers are all independent companies which may not be aggregated to determine whether they would be able to constrain the market power of the two remaining national suppliers. Their individual financial strength compared with that of Nestlé and BSN is extremely weak. Therefore, the combined market share of others of 17,7 % value and 25,8 % by volume in fact overstates the competitive strength of local water suppliers. Even if a few local waters are owned or supported by big retailers, this activity does not generate for these retailers a sufficient profit for them to invest important resources for the development of such sources. By contrast, Nestlé and BSN have a considerable financial strength which they are able and likely to use to develop their water activity which represents an important and very profitable business for them.

(74) Even if retail brands can combine several local spring waters under one umbrella, these waters are not a sufficient alternative and counterweight to the national mineral waters according to the retailers themselves (see Annex 15). This strategy of combining several spring waters under one brand can only to a limite extent improve the position of the local waters but cannot change the fact that there is a long-standing and well-established demand for the national mineral waters (over 70 % of total demand). In addition, spring waters from different sources sold under retail brand are generally at the lowest end of the local still waters. These waters are not really sold to compete with, but rather to complement the major national brands. They are the less likely to be accepted as a reasonable substitute by those consumers who regularly drink national mineral waters. At best, the retail brands will be successful in that segment of the market where consumers are merely looking for a replacement of tap water by the cheapest drink or household water (the tap-water replacement segment).

According to Nestlé's declarations at the oral hearing, retail brands represent at most 7 to 8 % by volume (much less by value) of the total still water segment. Since the retailers have these waters bottled by local water suppliers, their volume is already mostly included in the market share of others. It is only exceptional that a retailer owns a source and bottles itself the water.

Local mineral waters cannot by law be marketed under a retail brand or under several different brand names. According to Nestlé's figures, local still mineral waters represent only 6,5 % of all still mineral waters against 93,5 % in the hands of the three national suppliers.

(75) Given their low sales prices, the majority of local waters can only be marketed economically within a radius of 200 to 250 km. There is not a sufficient

margin for the producer to absorb transport costs over longer distances. In addition, the majority of local water sources have capacities of below (mostly far below) 200 million litres.

As a consequence, local water producers do not have sufficient volume and financial return to justify significant important invenstment in brand promotion, in national publicity or in a national distribution organization. Their waters have no strong brand image and are only sold regionally.

In contrast, the three national suppliers own sources with considerable capacities. They have invested for years in the image of their brands and in national distribution systems. They have crated a high fidelity of consumers who expect to find these national brands in all retail stores. The three national suppliers spent over FF 400 million in 1991 in advertising for the five major brands, ie. Contrex, Volvic, Vittel, Hépar and Evian, and in total over FF 680 million. After the merger, the financial resources of Perrier will be further increased by the combination with Nestlé's massive financial resources. No local spring water supplier could possibly try to compete on equal terms with the ramaining two suppliers as far as investments in advertising or nation-wide distribution systems are concerned. In its letter of 12 March 1992, Nestlé recognised that 'for smaller sources it is difficult to become a significant player in the French water market'.

(76) It must be concluded from the above that local water suppliers would not be able, at least in the short term, to significantly constrain the market power of the two remaining national water suppliers. Nestlé and BSN have clear competitive advantages compared with the local suppliers (much bigger sources, much better known brands, much better distribution and stocking systems) and have important financial resources to continue to invest heavily in national publicity and promotion campaigns. This strategy is liable to increase consumer fidelety to their well-known brands and thereby to reduce the cross-price elasticity of demand of their waters in particular *vis-à-vis* local spring waters. In addition, after the merger Nestlé would itself own a considerable number of local spring water sources (see recitals 51 and 52). It would thus have a full range of sources comprising mineral and spring waters which it could use in its sales strategy on the market.

F. **Buying Power**

(77) Nestlé, supported by BSN, has submitted that the three national suppliers are constrained by the buying power of the big retailers. Nestlé's 10 largest customers represent 67,3 % of its total turnover. Nestlé and BSN have submitted that four major retail groups, ie. Intermarché, Leclerc, Carrefour and Promodes, would represent 50 % of the total sales volume of the three national suppliers. In addition, some of the retailers sell local waters under own retail brands so that they are becoming competitors of the national water suppliers. The buying power would also be demonstrated by the fact that major brands have been delisted and that the average rebate granted by Vittel to its retailers has increased by 50 % during the years 1988 to 1992 (see *Lexecon Report,* p. 33).

(78) As regards the concentration of buyers, it is true that the 10 largest buyers represent an important part, around 70 %, of the turnover of all three national suppliers and, thus, have a certain purchasing power. However, concentration of these buyers is much less important than the concentration of the supply side, in particular after the merger. While 82 % by value and 75 % by volume (for still mineral waters over 90 %) of the supply side would be in the hands of only two suppliers which can easily engage in anticompetitive parallel behaviour (see recital 108 and following), the demand side is composed of a much greater number of independent companies, none of which exceeds 15 % of the total water turnover of all three/two suppliers. For Nestlé, the individual share of the ten largest buyers varies between 1,9 % and 11,6 % of Nestlé's total turnover. Out of ten buyers only four reach 10 to 11 %, the remaining six vary between 1,9 and 5,5 %. These purchasers do not all have an equal buying power based on the volume purchased. This is confirmed by the fact that the rebates granted to these retailers are not all identical but adapted to each individual buyer. All this shows that in front of a highly concentrated supply side, there is a demand side which is composed of a number of buyers which are not equally strong and which cannot be aggregated to conclude that they may constrain the market power of the three, and after the merger, only two national suppliers.

In the enforcement of the competition rules, the Commission must also pay attention to the protection of the weaker buyers. Even if some buyers might have a certain buying power, in the absence of sufficient competition pressure on the market, it cannot be excluded that Nestlé and BSN apply different conditions of sale to the various buyers.

(79) The buying power of retailers and wholesalers is also significantly limited by the fact that they cannot afford not to sell for a longer period of time the well-known brands of mineral waters supplied by Nestlé, Perrier and BSN because of the risk of losing customers. Over 70 % of total French water consumption and 90 % of all mineral water consumption would be concentraded on the two remaining national suppliers.

(80) In other cases decided by the Commission where buying power was one of the elements creating a counterweight, the products involved were generally intermediary products or products where long-term contracts or cooperation agreements for development of the products were involved which can create a more balanced seller-buyer relationship, provided the buyers are sufficiently concentrated. This is not the case for bottled waters which are widely used consumer products where the retailers only reflect the demand of consumer.

(81) Contrary to the statements made in the *Lexecon Report* (p. 48) on brand loyalty, it cannot be denied that the national supliers have created a high consumer fidelity for their respective brands through long-standing and heavy publicity campains which make their products to a large extent 'produits prévendus'. This is generally recognized by the professionals in the industry and by the retailers themselves who only reflect the demand of consumers.

(82) Thus, the Chambre syndicale des eaux minérales writes in its letter of 18 February 1992:

'. . . on trouve d'une part les grandes sources d'eaux minérales qui sont distribuées a l'échelon national et pratiquent une politique de notoriété de marque appuyée sur une forte publicité et autorisant des prix relativement élevés; d'autre part, des sources régionales, d'eaux de source ou d'eaux minérales, dont le dynamisme de commerialisation repose essentiellement sur des prix très bas.

Dans le premier groupe, qui fournit plus de 70 % des ventes intérieures, le marché est caractérisé par une forte identité de chaque source indépendamment de la Société ou du Groupe qui controle son exploitation et un attachement du consommateur habituel a ses marques préférées que l'on ne rencontre pas au même degré dans les autres pays. . .'

The Commission questioned a representative sample of retailers and wholesalers about the order of priority of their purchase criteria. A majority mentioned as first criteria the demand of consumers and the reputation of the brand (see Annex 14). Brand reputation and brand loyalty is also mentioned as a important feature of national mineral waters in a number of other replies (see Annex 15).

(83) After the merger and the sale of Volvic to BSN, Nestlé and BSN would own a bigger portfolio of well-known brands than each one of these two suppliers presently owns. They would eliminate competition from all major still and sparkling water brands of Perrier, in particular Perrier, Saint-Yorre, Contrex, Volvic, and thereby reduce the choice of retailers between several currently independent brands. This would inevitably increase the dependency of retailers and wohlesalers on the two remaining supliers. Not only would their choice be reduced from three to two suppliers but the tying of these brands operated by each supplier (rebates are made dependent on the sale of the whole range of products) would cover a wider range of reputable brands and thus further increase the dependency of retailers on the two remaining suppliers.

(84) A majority of the retailers and wholsesalers referred to in recital 82 have stated that they would become even more dependent on the national suppliers than up till now and that local spring waters are not a sufficient alternative for the national mineral waters. These statements are set out in full in Annex 15. The retailers and wholsesalers concerned (both major and smaller companies) express serious fears about their future margin of negotiation *vis-a-vis* Nestlé and BSN and consider that they have to sell the brands of these two suppliers. They also consider in general that local waters are more a complementary product than a real substitute for drinkers of national mineral waters.

(85) The weigthted average of the share of the sales of Nestlé, Perrier and BSN in the total water sales (still and sparkling 1991) of a representative sample of retailers and wholesalers amounts to approximately 78 % by volume and even higher by value. This shows the considerable weight of the brands of the

two remaining suppliers in the total water sales of a number of major retailers and wholesalers.

(86) As far as delisting of brands is concerned, Nestlé admits that it is unlikely that retailers would delist all the brands of a national supplier at the same time. This confirms the overall dependency of retailers on the national suppliers.

It is not denied that even only partial delisting can have a certain disciplinary effect on the supplier and that to that extent at least the biggest retailers have a certain buying power. However, this buying power is not the same for all retailers and is limited the larger the portfolio of brands in the hands of one supplier because each delisting immediately affects the annual full range rebates on all products (still, sparkling, flavoured, etc.). Therefore, the merger and the sale of Volvic to BSN would increase the portfolio of the two remaining suppliers and would make delisting in future more difficult than it is at the present time. In addition, delisting always provokes a certain switch of customers to other shops which sell their preferred brand. The exact percentage of such switch in each case is unpredictable and thus constitutes a factor of risk for the retailer (see Annex 15, retailer L) which limits its bargaining power.

(87) Nestlé has also stated that the fact that bottled water represents only an estimated 1 % of the sale of a retailer, whereas those same sales represent a much higher percentage of the turnover of the supplier, creates an imbalance in favour of the retailers. This does not reflect accurately the bargaining position of the retailers. According to the information provided by certain retailers, it is not excluded that a delisting of a national brand can result in a loss of one out of 10 end-consumers, who, because of their attachment to the brand, would switch retail outlet in order to find the particular brand. Therefore, a delisting of one single major brand can have a much higher impact on the retailer's sales than the 1 % figure would suggest, since the loss of each client implies a loss of all the client's purchases in the retail outlet concerned.

(88) Nestlé has finally submitted that buying power is demonstrated by the significant increase of rebates between 1988 and 1992. This argument cannot be accepted. The significant increases in list prices in both nominal and real terms have more than compensated for the increase in discounts. The effect is a net increase of the prices paid by retailers. Taking Vittel itself, the largest discount it granted to a retailer in 1987 was [. . .]% (calculated on the basis of all discounts in French francs granted during the year, including commercial cooperation in relation to the turnover in French francs achieved with that client).

In 1992, the largest discount granted by Vittel to a retailer represented [. . .] % of the turnover achieved with that customer. Certainly, the discount has nearly doubled in the last five years, as Nestlé has submitted. However, the list price of Vittel (1,5 l PVC) has increased from FF 1,92 (most favourable list price) in January 1987 to FF 2,49 in April 1992. Assuming that the total amount of discounts could be considered as such (including commercial cooperation), the price after discount has increased by [. . .] %. All other major brands have been able to increase their net prices even more (see Annex 13 [1]).

Therefore, even in a situation where three main suppliers are present on the market, retailers have not been able to counterbalance the ability of Nestlé, Perrier and BSN to increase their prices considerably during the last five years. After the merger, the buying power of the retailers is likey to be even more reduced.

(89) It must be concluded from the above that the buying power of retailers and wholesalers would not be sufficient to constrain significantly the market power of the two remaining national water suppliers after the merger. The merger would increase the portfolio of major well-known brands in the hands of Nestlé and BSN which must be on the shelves of each big retail store. The merger would also reduce the choice of the retailers from three to two sources of supply and would thus increase their dependency on the two major suppliers on the market. Given their increased dependency on the major brands, it would be more difficult for retailers to play one producer against the other. Also, the local spring waters do not represent a realistic alternative, at least not in the short term.

[1] Annex not published pursuant to the provisions of Article 17 (2) of Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets.

G. Potential Competition

(90) Nestlé has submitted that in view of the strong market growth for bottled water almost all major beverage and food manufacturers can be considered as potential competitors which would constrain the market power of Nestlé and BSN after the merger. Nestlé also refers to the large number of available sources in France and to a number of new market entries both by French local suppliers and by foreign suppliers. Nestlé mentions in particular, imports into France from Spa, Apollinaris and some Italian producers.

(91) To address the question of potential competition it needs to be examined whether there exists competitively meaningful and effective entry that could and would be likely to take place so that such entry would be capable of constraining the market power of the two remaining national suppliers. The question is not whether new local water suppliers or foreign firms can merely enter by producing and selling bottled water but whether they are likely to enter and whether they would enter on a volume and price basis which would quickly and effectively constrain a price increase or prevent the maintenance of a supracompetitive price. The entry would have to occur within a time period short enough to deter the company(ies) concerned from exploiting their market power.

(92) The Commission is of the opinion that there exist significant barriers and risks to enter the French bottled water market. These risks exist equally for new local water suppliers and new entrants from other neighbouring geographic markets. The reasons for difficult entry are set out hereinafter.

(93) Although the French water market has been growing very rapidly until 1990, this growth was halted in 1991 when the annual growth rate slowed down to below 1 %. France already has one of the highest per capita consumptions of water in the Community and it is therefore expected that the French water market will in future grow more slowly than the rest of the Community. This is admitted by Nestlé (see Lexecon Report, p. 47 and Mr Sedemund's letter of 12 March 1992, p. 16). The strong decline in demand growth in 1991 is probably not permanent but indicates that there is a certain limitation on demand growth in France.

(94) The French water market is a mature market in terms of number of brands and range of products. The market is already filled with a number of well-known and well-established brands which fully satisfy the retail stores and fill their limited shelf/stocking place. In the still water segment there are five major brands (Evian, Contrex, Vittel, Volvic, Hépar) established in virtually all distribution outlets. Entry with a sixth brand on a national or large scale basis would be very difficult. In addition, new brands with little or no reputation would not only have to be sold at much lower prices (e.g. the local waters) but would also have to offer retailers much larger discounts to induce a retailer to list a new brand which provides much less volume than any of the established well-known major brands.

(95) Access to French distribution is further rendered difficult by the fact that the established national suppliers grant to retailers and wholesalers annual rebates linking their respective products (rabais de quantité, rabais de gamme, rabais de progression, accords de coopération, etc.). These rebates and cooperation agreements go beyond pure quantity rebates because they pursue the objective of binding the buyers to the full range of products of each particular supplier. This type of rebate strengthens the position of the established suppliers and raises the barriers to entry for newcomers. Any newcomer would have to offer comparatively much greater rebates given his lower volume and lower range of products.

(96) One of the key problems of access to the French water market is the reputation of the established brands of the three national suppliers which grants Nestlé, Perrier and BSN a long-run advantage over any local supplier or newcomer.

The three national suppliers have invested for many years and continue to invest considerable sums in publicity and promotion for their respective brands (see recital 75). In 1991, Nestlé spent FF [...] million for the promotion of its brand Vittel. This represented around 10 % of its turnover achieved with the sale of that brand. In the same year, BSN spent also around 10 % of its turnover on the promotion of its brand Evian. The same was true for Perrier and its Volvic brand. High and long-standing spending in advertising has created a low elasticity of demand and thus a significant barrier to entry *vis-à-vis* local spring waters and *vis-à-vis* potential newcomers by constantly increasing consumer fidelity to the established brands. After the merger, Nestlé and BSN are capable and likely to continue heavy advertising of their respective brands because they have the required financial resources to do so and because this strategy contributes to deterring potential entrants and maintaining the price gap and reduced elasticity of demand towards the local water suppliers.

(97) Advertising and promotion are sunk costs which are not recoverable in the case of failure in the market. For newcomers the establishment of a new brand is not only very costly and time consuming (consumer acceptance can take several years), but is also extremely risky because in case of failure (non-acceptance of the brand by the consumer) all the investment is lost. As was explained in recital 96, the establishment of a new brand in the mature French market would be extremely risky. In the bottled water market, advertising is required to sell significant amounts of the product. The advertising costs are costs which constitute a considerable disadvantage for newcomers compared with the established firms because newcomers cannot recuperate these costs on high current sales volumes.

(98) High concentration in itself is a barrier to entry because it increases the likelihood and the efficiency of single or concerted reaction by the established firms against newcomers with a view to defending the acquired market positions and profitability. The joint action by Nestlé and BSN to oppose the public bid made by Ifint (the Agnelli Group) on Exor (Perrier) was a clear sign of a fierce reaction against the acquisition of Perrier by a firm which could have disturbed the existing market structure.

(99) All these difficulties were confirmed to the Commission by virtually all interested companies questioned about the ease or difficulty of access to the French water market (see extracts made available to Nestlé by Commission letter of 14 May 1992). One very illustrating reply on this question is set out in Annex 16 ([1]).

(100) Contrary to the assertion made by Nestlé, all the companies contacted by the Commission confirmed that they had no concrete plans to enter the French water market. The answers received show that if there are potential entrants they consider entry too risky, particularly in case the merger Nestlé/Perrier were to take place. In any case, entry *ex novo* would require the building of a plant, the application for an authorization to exploit a source, the establishment of distribution links and the establishment of a brand, all of which can take a considerable period of time for a newcomer.

(101) Nestlé and BSN have drawn the Commission's attention to the fact that there exist a large number of mineral and spring sources in France which can be developed and have pointed towards a number of entries of local suppliers (see in particular Lexecon Report, p. 58). However, none of these sources are of a size in capacity or sales comparable to the major sources of Nestlé, Perrier and BSN. There is no indication that any of these sources would be able to develop quickly to a point that they could significantly restrain the market power of the two remaining national suppliers. In its letter of 12 March 1992, p. 14, Nestlé admitted that for smaller producers the investment in marketing and advertising makes it difficult to become a significant player in the French water market. It is not denied however that local suppliers can develop and have, but this development is limited to regional areas and to a particular segment of the market which does not and is not likely in the short term to significantly restrain the market power of the national mineral waters. This is best proved by the fact that the three national suppliers were able to constantly increase their prices both in nominal and in real terms despite the increase of sales of local spring waters.

(102) The agreement concluded between Nestlé and BSN by which Nestlé has agreed to sell the Volvic source to BSN for a price exceeding FF [. . .] million could not be explained if it was in fact very easy to enter the French water market by developing new springs and new brands. This agreement shows that a significant entry or expansion in that market can be made only through the acquisition of a major source. With the acquisition of Perrier owning the biggest capacities on the market and the agreement to sell Volvic to BSN, all possibilities for acquisition of major water sources and brands in France by a newcomer would be foreclosed by the two suppliers remaining in that market.

(103) Nestlé has further referred to some imports by Spa, Apollinaris and some Italian producers.

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Firstly, it is noted that so far no foreign beverage or food company of a size similar to Nestlé, Perrier and BSN has acquired a French water source with a capacity equivalent to that of the major sources owned by the three established suppliers.

Secondly, according to Perrier, several foreign companies have tried to import and sell on the French market during the last five years. Only a few are still present but none has achieved any significant volume of sales and none has been able to establish a brand name which could in the short term significantly compete with the wide range of brands owned by the three established supppliers.

(104) The sales of Spa in France (mainly canned still water sold through Coca-Cola vending machines) are negligible and have not succeeded in increasing since their introduction into France. The same is true for the sales of Apollinaris and the Italian producers San Pellegrino (20 % owned by Perrier), Ferrarelle (belonging to BSN), Levissima and San Benedetto. The imports of these latter companies are not in the still water segment but in the sparkling water segment and are principally directed towards the CHR (cafés, hotels, restaurants) sector. They are handicapped by a higher cost of transport in particular because they are mainly sold in glass bottles. As regards the German and Italian waters, these are sold at a higher price than French sparkling waters and thus cannot be considered as a price-constraining factor for French waters.

(105) Nestlé has also argued that there is a strong production substitutability between soft drinks and bottled water and that this should at least be taken into account for the assessment of the question of dominance. However, this production substitutability is only possible as far as purified treated table water is concerned, which can easily be produced by soft drink producers. This type of water is not marketed by anyone in France. It would not be a very good way to enter into competition with the existing French mineral and spring waters and it would involve high marketing costs and very high risk/high sunk costs. There is no existing or foreseeable demand for purified treated water in France (see recital 18).

(106) Finally, Nestlé has argued that end consumer prices of numerous soft drinks, in particular Coca-Cola drinks, are in the same range as end-consumer prices of bottled water and that Coca-Cola has confirmed to the Commission that its prices are targeted at bottled water. There would thus exist a certain degree of demand substitutability between soft drinks and waters which should be taken into account for the question of dominance. This argument cannot be accepted. The end consumer prices for colas and still mineral waters (which are the products at the centre of discussion in this case) are clearly different (see recital 13). In its letter of 12 March 1992, p. 5, Nestlé recognised that still mineral water products appear to be a cheaper alternative for the consumer. Basically, still water is roughly half the price of colas (see also Goldman Sachs Report of 9 September 1991, p. 8).

(107) It must be concluded from all the above that there is no effective price-constraining potential competition which could quickly and significantly constrain the market power of the two suppliers remaining on the French water market. The risk associated with entering that market would be increased by the proposed merger since newcomers would have to face a strengthened power and since all the major brands of Perrier would be foreclosed for acquisition by potential entrants.

H. Impact on the maintenance or development of effective competition

(a) *In the case of implementation of the sale of Volvic to BSN: duopolistic dominance*

(108) Given the high market shares and capacities of Nestlé and BSN after the merger and the sale of Volvic to BSN, the insufficient competitive counterweight from local mineral and spring waters, the increased dependency of retailers and wholesalers on the portfolio of brands of Nestlé and BSN, the absence of effective price-constraining potential competition from newcomers and the other characteristics outlined hereafter, the Commission must conclude that the proposed merger between Nestlé and Perrier would create a duopolistic dominant position which would significantly impede effective competition on the French bottled water market. This market constitutes a substantial part of the common market.

(109) Nestlé, supported by BSN, has submitted that Article 2 (3) of the Merger Regulation does not apply to oligopolistic dominance and, if it did, that

the Commission has not proved the absence of significant competition between the established national suppliers and the absence of actual or potential competition from outside the oligopoly.

(i) Application of Article 2 (3) of the Merger Regulation to oligopolies

(110) Article 2 (3) of the Merger Regulation stipulates: 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 question is whether this provision covers only a market situation where effective competition is significantly impeded by one firm which alone has the power to behave to an appreciable extent independently of its competitors, customers and consumers, or whether this provision also covers market situations where effective competition is significantly impeded by more than one firm which together have the power to behave to an appreciable extent independently of the remaining competitors, of customers and ultimately of consumers.

(111) Nestlé has not denied the fact that from an economic point of view, both single firm dominance and oligopolistic dominance can significantly impede effective competition under certain market structure conditions (see Mr Sedemund's submissions of 19 May 1992, p. 44 and following; Lexecon Report, pp. 61 to 62).

(112) The Commission considers that the distinction between single firm dominance and oligopolistic dominance cannot be decisive for the application or non-application of the Merger Regulation because both situations may significantly impede effective competition under certain market structure conditions. This is in particular the case if there is already before the merger weakened competition between the oligopolists which is likely to be further weakened by a significant increase in concentration and if there is no sufficient price-constraining competition from actual or potential competition coming from outside the oligopoly.

(113) Article 3 (f) of the EEC Treaty provides for the institution of a system ensuring that competition in the common market is not distorted. One of the principal goals of the Treaty is thus the maintenance of effective competition. The restriction of effective competition which is prohibited if it is the result of a dominant position held by one firm cannot become permissible if it is the result of more than one firm. If, for instance, as a result of a merger, two or three undertakings acquire market power and are likely to apply excessive prices this would constitute an exercise of a collective market power which the Merger Regulation is intended to prevent by the maintenance of a competitive market structure. The dominant position is only the means by which effective competition can be impeded. Whether this impediment occurs through single firm power or collective power cannot be decisive for the application or non-application of Article 2 (3) of the Merger Regulation.

(114) In the absence of explicit exclusion of oligopolistic dominance by Article 2 (3) it cannot be assumed that the legislator intended to permit the impediment of effective competition by two or more undertakings holding the power to behave together to an appreciable extent independently on the market. This would create a loophole in the fundamental Treaty objective of maintaining effective competition at all times in order not to jeopardize the proper functionning of the common market. If, in order to avoid the application of the Merger Regulation, it sufficed to divide the dominant power between for instance two companies in order to escape the prohibition of Article 2 (3), then, in contradiction to the basic principles of the common market, effective competition could be significantly impeded. In such a hypothesis the objective of Article 3 (f) of the EEC Treaty could be overturned.

(115) Seen in the light of these legal and economic considerations, Article 2 (3) must be interpreted as covering both single firm and oligopolistic dominance. It is also significant to note that all other major antitrust systems with a merger control system apply or can apply their rules to both single firm and oligopolistic dominance, e.g. the American system, the French law (Article 38 of the Law of 1 December 1986); German law (22 GWB) and UK law (Fair Trading Act, Section 6 (2)). In most of these systems, it is an established practice to control mergers raising a problem of oligopolistic dominance. It cannot be the case that following the adoption of the Merger Regulation mergers which previously were subject to such control would now be subject only to single firm dominance

control. The Merger Regulation would not only have transferred the national merger control powers to the Community but those Member States which had a system with oligopolistic dominance control would at the same time have abandoned such control altogether without any substitute for it at Community level. In the absence of any express provision to that effect, such a cession of control cannot be assumed.

(116) The argument of BSN that the Commission would be violating the principle of legal certainty because this case would be the first case to apply the oligopolistic dominance concept cannot be accepted. As explained above, the correct interpretation of the Merger Regulation leads to the conclusion that Article 2 (3) has always covered dominance which significantly impedes effective competition independently of whether such situation is the result of one or more than one firm. Furthermore, if the argument of BSN was right, it would mean that the Commission could never develop any of its administrative case law. Although BSN's argument could under other circumstances have some relevance in particular where *a posteriori* control takes place and involves interference in acquired rights, the merger control system is an *a priori* control system which by definition does not allow the implementation of mergers without prior authorization by the Commission.

(ii) Creation of a duopolistic dominant position

(117) Although Nestlé has stated that the Commission has not proved absence of significant competition between the suppliers, it has not brought forward any arguments to rebut the indicators mentioned by the Commission in its statement pursuant to Article 18 to the effect that, even before the merger, price competition between these suppliers was greatly weakened in particular the high degree of price parallelism over a long period of time, the very high production cost-price margin, and the large gap between ex-works prices of national mineral waters and local spring waters.

(118) The Commission has not asserted that there existed an oligopolistic dominance between Nestlé, Perrier and BSN even before the merger. The facts and market structures show, however, that the French bottled water market is already a highly concentrated market where price competition is considerably weakened. The maintenance or development of whatever competition there remains on that market therefore requires particular protection. Any structural operation restricting even more the scope for competition in such a situation has to be judged severely. The combination of the market structure arising from the merger and of certain additional factors (see recitals 119 to 120) lead to the conclusion that the proposed merger would have the effect of creating a duopolistic dominant position allowing Nestlé and BSN to jointly maximize profits by avoiding competition among themselves and acting to a large extent independently of their customers and competitors.

(119) After the merger, the degree of concentration would be extremely high with Nestlé and BSN holding over 82 % of the total French water market by value and 75 % by volume (nearly 95 % of all still mineral waters). There would only be two national still and sparkling mineral water suppliers on the French market. Both suppliers would operate in the most profitable segment of bottled water and have a strong interest and incentive to jointly defend their position.

After the merger, there would be no competitor in the Community approaching the size, the range of well-known brands and the geographic spread of either Nestlé or BSN. The remaining main company not linked to Nestlé or BSN would be Spa in Belgium, with total sales of 256,3 million litres of bottled water in Belgium and a turnover of Bfrs 8,05 billion in 1989 (ECU 185 million) which is several times smaller than that of Nestlé or BSN. The leading German bottlers are also much smaller. Apollinaris sales in Germany amounted in 1990 to approximately 345 million litres. Gerolsteiner Brunnen (427 million litres) and Mineralbrunnen Überkingen (490 million litres) are also well below Nestlé or BSN in size.

(120) The reduction from three to two suppliers (duopoly) is not a mere cosmetic change in the market

structure. The concentration would lead to the elimination of a major operator who has the biggest capacity reserves and sales volumes in the market. Perrier sources and brands would be divided between the two remaining suppliers. In addition, the reduction from three to only two national suppliers would make anticompetitive parallel behaviour leading to collective abuses much easier.

(121) The mineral water suppliers in France have developped instruments of transparency facilitating a tacit coordination of pricing policies

Retail prices of bottled water are transparent. The packaging and product size of the main products are the same in this market. Retail prices can easily be checked, and statistics are regularly supplied by different organizations.

In addition, Perrier, Vittel and BSN publish all tariff prices which are readily comparable (ex-works, taxes excluded, per bottle and for different means of transport). These basic prices constitute a reference on which pricing policies can be tacitly coordinated. An analysis of tariff price evolution through time (in real terms, i.e. effect of general inflation excluded) shows a high degree of price parallelism (see Annexes 5 to 8 [1]).

(122) Companies have developed instruments allowing to control and monitor each other's behaviour

Homogeneity and transparency of tariffs allow the mutual monitoring of pricing policies of competitors. In addition, Perrier, BSN and Vittel have implemented a mechanism of regular exchange of information on quantities sold each month, broken down by major brands. This allows each one of them to follow permanently, on a monthly basis, the behaviour and the sales evolution of each other. Moreover it would also permit immediate detection of any deviation by any single major brand of the expected performance.

After the merger, these instruments may become less indispensable given the reduction in suppliers on the market and the resulting increased transparency of the market itself. It also needs to be remembered that these suppliers carry out the bulk of their sales with the same customers.

(123) The two players remaining in the market are similar in size and nature

After the merger, there would remain two national suppliers on the market which would have similar capacities and similar market shares (symmetric duopoly): in the still water segment their market shares by volume would be Nestlé [. . .] %, BSN [. . .] % for all still waters and Nestlé [. . .] %, BSN [. . .] % for still mineral waters. By value, their market shares would be Nestlé [. . .] %, BSN [. . .] % for all still waters.

Given this equally important stake in the market and their high sales volumes, any aggressive competitive action by one would have a direct and significant impact on the activity of the other supplier and most certainly provoke strong reactions with the result that such actions could considerably harm both suppliers in their profitability without improving their sales volumes. Their reciprocal dependency thus creates a strong common interest and incentive to maximize profits by engaging in anti-competitive parallel behaviour. This situation of common interests is further reinforced by the fact that Nestlé and BSN are similar in size and nature, are both active in the wider food industry and already cooperate in some sectors of that industry.

(124) Demand is relatively price-inelastic; prices might be increased without fear of offsetting losses in volume

Because of the motivation of consumers to buy and consume mineral water on a daily basis, there are no real substitutes for mineral water. The overall image of branded water and brand loyalty accentuate the price-inelasticity of demand.

Increases in real prices have therefore a proportionately smaller impact on quantities demanded; a price increase would result in increased total revenue and profits. The incentive and possibility to increase prices jointly in this market

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seems to have already been recognized by the companies in the past (see the Annexes [1] showing price evolution in the last five years, in particular real prices). The proposed concentration facilitates and reinforces the likelihood of such a strategy being tacitly adopted by Nestlé and BSN. Both companies share a long common experience in the bottled water market in France.

(125) Costs are similar. No company seems to enjoy a significant cost advantage

It could be argued that companies facing different cost conditions could have a very different view on the prices they would like to prevail in the market whereby tacit coordination of pricing policies, without express and binding agreements among the companies, could become extremely difficult. Significant differences in costs can reasonably be considered an element that would hinder the implementation of tacit parallel behaviour.

This element is not present in this market. The raw material (source water) is free. The manufacturing process consists basically in bottling, which is a well-established technology where it would be difficult to gain a major technological advantage. The need to bottle at the source, and the resulting multiplicity of bottling plants reduces the scope for economies of scale. Finally, Nestlé has confirmed that the costs of the three major suppliers are not very different and the information provided to the Commission in this respect confirms this view.

(126) Technology is mature. R&D play no major role

The basic manufacturing process of the parties consists in bottling, which is a well-established technology. Nestlé has not given any indication of expected major changes in this respect. In addition, the scope for product innovation in the market of water is reduced. The water industry cannot be considered as an industry based on research, where new technological developments might quickly erode acquired positions. Research and development activities in this market are in fact of minor importance. The total expenditure of Nestlé in R&D with respect to waters (1,5 % of the annual turnover achieved in the sector) is a clear indication in this respect. This figure is lower than the average expenditure in the food sectors (see p. 33 of the notification). It can also be compared with the 15 to 25 % of turnover devoted by typically innovative industries to R&D.

(127) The notified operation in itself weakens the likelihood of the development of competition among Nestlé and BSN

Nestlé and BSN have together reacted strongly to the attempt by an external actor (Ifint) to acquire Perrier. Since BSN and Vittel have smaller spare capacities than Perrier, Perrier under ownership of a third party coming from outside the water market could have constituted an element of uncertainty and disruption in the market. The joint reaction of Nestlé and BSN to Ifint's bid can be viewed in this sense as a joint entry deterrence action.

(128) The subsequent agreement between Nestlé and BSN to share Perrier (sale of Volvic) further weakens the likelihood of development of competition between Nestlé and BSN. The competition between the two suppliers would further be reduced by the fact that BSN would hold two brands (Evian and Volvic) with a low mineralization degree (below 500 milligrams per litre) while Nestlé would hold three brands (Contrex, Vittel and Hépar) with a high mineralization degree (above 500 milligrams per litre). This split of brands would increase the product differentiation between the two suppliers with the result that competition would be further weakened and buyers would become even more dependent on each of these two suppliers. Finally, end consumers will suffer the consequences of the absence of competition in this market in terms of higher prices.

(129) Fringe firms (local spring waters) or retailers do not constitute a sufficicent competitive constraint

Local spring and mineral waters are too small and dispersed to constitute a significant alternative to the national waters. As examined in recitals 64 ff, none of these companies constitutes a sufficient price-constraining competitive force, which would be able to undermine the possibilities offered by the structure of the affected markets to BSN and Nestlé to jointly maximise their profits by avoiding competition among themselves. The same is true as regards the alleged buying power of retailers (see recitals 77 ff). None of these forces in the market has

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been able in the past to prevent the national mineral water suppliers from constantly increasing in parallel their prices in real terms.

(130) Barriers to entry are high

The conditions of entry and the effect of potential competition on the French water market have been examined above. It cannot reasonably be expected that actual entry or the threat of likely entry would jeopardize the ability of Nestlé and BSN to profitably increase their prices jointly in the future.

In addition, the merger in itself increases even further the associated risks and difficulties faced by newcomers.

(iii) Conclusion

(131) It must be concluded from all the above that the market structure resulting from the merger between Nestlé and Perrier (followed by a sale of the Volvic source to BSN) would create a duopolistic dominant position on the French bottled water market which would significantly impede effective competition and would be very likely to cause a considerable harm to consumers. Given the value of the total French water market (over FF 9 000 million per year) and the volume of water bought by French consumers (among the highest consumption rate per capita in the Community), the power to increase the prices of bottled water by only a small, but significant percentage (for instance 5 %) would lead to considerable losses for consumers.

(b) *Without the sale of Volvic to BSN: single firm dominance*

(132) If the Volvic agreement was not implemented, the proposed merger between Nestlé and Perrier would create a dominant position for the new entity by affording it the power to behave alone to an appreciable extent independently of its competitors, its customers and ultimately its consumers.

(133) The factors leading the Commission to this conclusion are as follows:

— the high market share in the French water market (approximately 60 % by value and 53 % by volume) which is more than twice the market share of the next biggest competitor,

— the combined overall and free capacities of the new entity both for still and sparkling waters: these capacities represent a multiple of those of the next biggest competitor and exceed by far the volume of the total water market,

— the portfolio of mineral water sources owned by Nestlé/Perrier: eight still mineral water sources of which three major sources (Contrex, Volvic and Vittel) and seven sparkling mineral water sources of which two major sources (Perrier and Saint-Yorre); this would create a major advantage *vis-à-vis* its competitors,

— the new entity would also hold an important number of spring water sources,

— at national level there would be one other competitor, BSN, with only one major still water source (Evian) and one major sparkling mineral water source (Badoit); BSN has a reserve of still mineral water which only leaves it a limited scope of action to compete with Nestlé/Perrier in the medium and long term. In the sparkling mineral water segment, its source Badoit has reached full capacity and can thus no more respond to an increase in demand,

— the competition from local spring waters would be insufficient to constrain the scope of action of Nestlé/Perrier,

— retailers and wholesalers would become even more dependent on the well-known brands of the new entity and could thus not effectively constrain the market power of Nestlé/Perrier,

— there is no sign of a price-constraining potential competition which could quickly and effectively enter the French water market.

(134) If in spite of its limited free capacity of Evian, BSN nonetheless maintained some scope of action to compete against Nestlé/Perrier, it cannot be expected that BSN would effectively compete against Nestlé/Perrier since both suppliers would have a strong common interest and incentive to jointly maximize profits.

In the still mineral water segment, BSN has only one major brand, i.e. Evian, with which it supplies both the French market and export markets. It is very unlikely that BSN would decide to use its available capacity to take away any significant volume from Nestlé/Perrier because it will want to participate in the increase in total demand and also maintain and if possible increase its exports. It can therefore be anticipated that BSN could not or would not effectively compete against Nestlé/Perrier.

I. Conclusion

(135) For all the reasons outlined above, the Commission concludes that with or without the sale of Volvic to BSN the proposed merger would create a dominant position as a result of which effective competition would be significantly impeded in a substantial part of the common market within the meaning of Article 2 (3) of Council Regulation No 4064/89.

VI. COMMITMENTS PROPOSED BY NESTLÉ

(136) Nestlé has offered to modify the original concentration plan as notified by entering into the following commitments:

While maintaining fully its position adopted in its written and oral replies to the Statement of the Commission pursuant to Article 18 of Regulation (EEC) No 4064/89 and dated 4 May 1992, Nestlé hereby declares that it is prepared to modify the effect of the operation notified to the Commission on 25 February 1992 on the basis of the following undertaking:

In order to meet the requirements of the Commission to facilitate the entry of a viable competitor with adequate resources in the bottled water market or the increase in the capacity of an existing competitor so that in either case such competitor could effectively compete on the French bottled water market with Nestlé and BSN, Nestlé has undertaken that it will make available for sale both brand names and sufficient capacity of water for bottling to such competitor as will permit that competitor to have not less than 3 000 million litres of water capacity per annum.

The brand names and sources to be divested are the following:

(million litres)

Spring	Capacity
Vichy	[...]
Thonon	[...]
Pierval	[...]
Saint-Yorre	[...]
A number of other water sources	1 195

The above capacity figures represent the best knowledge of Nestlé. The capacity figures are approximate but Nestlé undertakes to have these figures confirmed by an expert opinion.

Nestlé will be restrained from directly or indirectly providing any data that is less than one year old on its sales volumes to any trade association or any other entity which would provide that information to other competitors in the market in a form enabling other competitors to directly or by deduction identify the exact sales volumes of Nestlé. Nestlé agrees not to provide such data for as long as the present narrow oligopolistic market structure persists in the French bottled water market. Nestlé may at any time petition the Commission to show that market conditions and structure in the French bottled water market have changed sufficiently to allow a modification of this undertaking.

Nestlé agrees to hold separate from its own operations all assets and interests acquired from Perrier, until it has completed the sale of all bottled water operations described above to a single entity which is approved by the Commission. The buyer must be an entity that has no structural, financial or personal relationships with Nestlé, Perrier or BSN or any of the parent entities, or any of the subsidiaries of, or any officers, directors, employees, or agents of Nestlé, Perrier or BSN, which relationships are of such a nature that it would be unlikely that the buyer would compete effectively with Nestlé and BSN.

During the aforementioned period of separate holding, pending the sale of the assets to be divested, Nestlé also agrees that there will be no structural changes made in Perrier's business operations, such as the sale of a trademark or brand, the sale of a business unit, the closing of a manufacturing unit, or any disposal of similar major assets (including leasing, assigning or pledging of such assets) without prior Commission approval. Such approval will be deemed to be given if the Commission does not communicate in writing to Nestlé its opposition within 15 working days of the receipt of the notification of the intended structural change.

Until the divestiture required by this Decision has been accomplished, Nestlé:

(a) shall take all reasonable steps to assure that the assets of the Perrier group as a whole are maintained as distinct and saleable assets, and

(b) shall preserve the documents, books and records relating to Perrier.

During the aforesaid period of separate holding, Nestlé undertakes not to permit the Perrier management to transfer any business secrets, know-how, commercial information or any other industrial information or property rights of a confidential or proprietary nature that it obtains from Perrier to any other commercial entity within the Nestlé group, nor to use any such information within the Nestlé group other than for the purposes of selling the assets which are the subjects of this commitment.

Nestlé agrees to sell the assets concerned by [. . .]. Nestlé shall be deemed to have complied with this obligation if, by [. . .], it has entered into a binding contract for the sale of the divestiture assets to a purchaser approved by the Commission, provided that such sale is completed within a time limit agreed to by the Commission.

Nestlé shall take all reasonable steps to accomplish the abovedescribed divestiture on or before [. . .]. The Commission may, in its sole discretion, upon Nestlé's request and upon showing good cause at any time on or before [. . .], extend said period for an additional three months.

Nestlé acknowledges that the approval of the purchaser by the Commission is of the essence for the acceptance of its undertaking by the Commission. The establishment of an effective competitor *vis-a-vis* Nestlé and BSN depends on the strength of the purchaser to develop the sources and brands which will be sold to it. The purchaser must in particular have:

— sufficient financial resources to develop a nation-wide distribution organization and to adequately promote the acquired brands;

and

— sufficient expertise in the field of branded beverage or food products.

These are the two main criteria. The Commission will withhold approval only if it can show that the proposed purchaser will not be a credible competitor or is unlikely to compete effectively with Nestlé and BSN, despite meeting these two criteria.

Nestlé acknowledges that it will be a condition of the Decision that Nestlé will not sell Volvic to BSN unless and until such time as it has fully completed the sale of the bottled water assets to be divested, it being understood that the sale of such assets is a prerequisite to a finding of compatibility with the common market.

Nestlé is enjoined and restrained from re-acquiring, directly or indirectly, any of the sources or brands which it divests pursuant to this undertaking, for a period of 10 years from the date of this Decision, without the prior written approval of the Commission. In this context, the Commission will take into consideration any changes in the market structure of the French bottled water market.

Without prejudice to its obligations under the Merger Regulation in respect of Community-dimension mergers, Nestlé also undertakes to inform the Commission in writing of any acquisition of a bottled water entity in France with a market share of sales exceeding five percent (5 %), for a period of five years from the date of the Commission decision.

(137) The Commission is satisfied that Nestlé's offer contains a range of mineral and spring water sources which would put in the buyer's hands the stated amount of approximately 3 000 million litres of capacity.

Nestlé has undertaken to sell the above capacity and brand portofolio of mineral and spring waters which should create effective competition to counteract the duopolistic dominance which would otherwise result from the proposed concentration and the sale of Volvic to BSN.

Provided that the buyer of the proposed bundle of brands and sources has the ability to develop quickly the assets which Nestlé will sell, the capacities offered would be, in the Commission's opinion, sufficient to create a new competitive entity in the French bottled water market which is likely to constrain the market power of Nestlé and BSN.

The new entity will have at its disposal a capacity of the French bottled water market which amounts to approximately 20 % of the total capacity previously held by the three established national suppliers and which is sufficient to cover more than half of the present total market demand. Although the present sales of these brands are still very low, their potential for development is high given the capacities and the required characteristics that the buyer must possess.

The sources to be sold include sources of still mineral water, still spring water, and sparkling water. They also contain a number of already well-established brands, or brands which are about to become nationally distributed brands in each of these water segments.

The buyer of this package will acquire a foothold in major retail stores, access to which is necessary to enable any new entrant to promote other lesser-known brands and to introduce new brands.

This, however, means that the buyer must have sufficient expertise in developing food brands and has sufficient financial resources to invest in the publicity required to support these brands.

Provided this is the case, it can be expected that the new entity will be albe to offer an alternative to consumers at prices below the high-priced national mineral waters. This type of market positioning could counteract the current pricing policies of the three national suppliers.

Therefore, subject to the fulfilment of the conditions and obligations set out in Nestlé's commitment, the Commission has concluded that the sale of a capacity of 3 000 million litres and of the agreed portfolio of brands to a strong buyer acceptable to the Commission would be sufficient to create a viable competitor able effectively to compete with Nestlé and BSN and thus to prevent the collective dominant position which would otherwise be created by the proposed concentration and the subsequent sale of Volvic to BSN.

(138) If the sale of the assets to be divested has not taken place by the end of the time period set out in Nestlé's commitment, or if any of the other obligations accepted by Nestlé are breached, then the Commission reserves the right, pursuant to Article 8 (5), to revoke its decision to accept the modifications proposed here and to require that Nestlé divest all assets and interests in Perrier and thereby that Nestlé and Perrier be fully separated in order to restore conditions of effective competition, as provided by Article 8 (4).

These actions will be taken without prejudice to the Commission's right to impose fines pursuant to Article 14 (2),

HAS ADOPTED THE FOLLOWING DECISION:

Article 1

Subject to the full compliance with all conditions and obligations contained in Nestle's commitment *vis-à-vis* the Commission as set out in recital 136 of this Decision, the concentration notified by Nestlé SA on 25 February 1992 relating to the acquisition of control over Source Perrier SA is declared compatible with the common market.

Article 2

This Decision is addressed to:

Nestlé SA,

55, avenue Nestlé,

CH-1800 Vevey.

Done at Brussels, 22 July 1992.

For the Commission

Leon BRITTAN

Vice-President

OPINION

of the Advisory Committee on Concentrations given at the 11th and 12th meetings on 3 and 14 July 1992 concerning a preliminary draft decision relating to case IV/M.190 — Nestlé/ Perrier (1)

(92/C 319/03)

1. The Committee shares the opinion of the Commission on the definition of product and geographic markets proposed in the preliminary draft decision.

2. The Committee agrees with the Commission's economic analysis according to which the acquisition of Perrier by Nestlé and subsequent sale of Volvic to BSN delineates a collective dominant position on the relevant market.

   A minority believes that this would also strengthen a pre-existing collective dominant position.

   Another minority considers that the buying power of the distribution sector has been underestimated.

3. The majority of the Committee considers that Regulation (EEC) No 4064/89 can be applied to declare that the creation or reinforcement of a collective dominant position is incompatible with the common market.

   A minority, in keeping with the jurisprudence of the Court of First Instance, is of the view that the Regulation does not cover cases of collective dominance except where there are proven economic links between the undertakings.

   Another minority, with regret, does not believe that the Regulation can be applied to a collective dominant position.

4. The Committee considers that in the case that the sale of Volvic to BSN should not take place Nestlé would acquire a dominant position after the concentration incompatible with the common market.

   A minority believes that with this concentration there would be a strengthening of the pre-existing dominant position of the oligopoly on the market.

5. The majority of the Committee considers that, in agreement with the Commission, in its present configuration, the concentration must be declared incompatible with the common market.

6. A majority of the Committee is of the opinion that Nestlé's commitments entered into with the Commission concerning a divestiture of the activities are sufficient to render the concentration compatible with the common market, provided that it will be possible to find an independent buyer with sufficient financial strength and technical capacity to ensure the rapid development of the activities sold off by Nestlé as has been proposed by Nestlé itself.

   A minority is of the opinion that the commitments negotiated with Nestlé are insufficient to insure effective competition in the market, particularly in view of the limited market shares of the brands to be divested.

7. A majority of the Committee is of the opinion that the other conditions imposed on Nestlé by the Commission and accepted by Nestlé are necessary in order to maintain competition in the market.

8. The Committee asks the Commission to take into account all points raised in the discussion.

9. The Committee recommends publication of this opinion.

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(1) OJ No L 356, 5. 12. 1992, p. 1.

COMMISSION

COMMISSION DECISION

of 30 September 1992

declaring the compatibility of a concentration with the common market

(Case No IV/M214 — Du Pont/ICI)

(Only the English text is authentic)

(93/9/EEC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings [1], and in particular Article 8 (2) thereof,

Having regard to the Commission Decision of 3 June 1992 [2] to initiate proceedings in this case,

Having given the undertakings concerned the opportunity to make known their views on the objections raised by the Commission,

Having regard to the opinion of the Advisory Committee on Concentrations [3],

Whereas :

I. BACKGROUND

The nature of the proceedings

(1) These proceedings concern the proposed acquisition of the worldwide nylon operations of Imperial Chemical Industries plc (ICI) by E.I. du Pont de Nemours and Company (Du Pont) which was notified on 30 April 1992 pursuant to Article 4 of Council Regulation (EEC) No 4064/89 (the 'Merger Regulation').

(2) On 20 May 1992 the Commission decided to continue the suspension of the concentration pursuant to Article 7 (2) of the Merger Regulation, and on 3 June 1992 the Commission initiated proceedings in this case pursuant to Article 6 (1) (c) of that Regulation.

The parties

(3) Du Pont is a US-based group with worldwide activities in particular in the chemical and petroleum industries. In 1991, the worldwide sales of Du Pont were around ECU 31 billion, of which around 30 % were accounted for by sales of polymers and fibres. The overall turnover of Du Pont in the Community in 1991 was around ECU 9 billion.

(4) ICI is a UK based group with international activities in particular in chemical and related industries. In 1991 the worldwide sales of ICI were around ECU 18 billion, of which nylon accounted for around ECU 800 million.

II. THE CONCENTRATION

(5) The acquisition of the nylon business of ICI by Du Pont is a concentration within the meaning of Article 3 (1) of the Merger Regulation.

III. COMMUNITY DIMENSION

(6) The aggregate worldwide turnover of Du Pont and of the nylon business of ICI which is the subject of the transaction exceeded ECU 5 billion in 1991.

[1] OJ No L 395, 30. 12. 1989, p. 1 ; corrected version : OJ No L 257, 21. 9. 1990, p. 13.
[2] OJ No C 144, 6. 6. 1992, p. 10.
[3] OJ No C 8, 13. 1. 1993, p. 2.

Both Du Pont and ICI's nylon business have a Community-wide turnover of more than ECU 250 million, and they did not achieve more than two-thirds of their Community-wide turnover in one and the same Member State. Thus the concentration has a Community dimension within the meaning of Article 1 (2) of the Merger Regulation.

IV. ASSESSMENT PURSUANT TO ARTICLE 2 OF THE MERGER REGULATION

1. **Structure of the nylon industry**

(7) Nylon (or polyamide as it is also known) is created from successive chemical processes. There are three basic steps to obtain nylon fibre :

— step one involves the production of the raw material. This is caprolactam for the so-called nylon 6 process, and nylon salt (hexamethylene diamine adipate) for the so-called nylon 6.6 process. Caprolactam and nylon salt are produced in a chain involving the transformation or mixing of several intermediates. The most important nylon specific intermediates for nylon 6.6 are adiponitrile (ADN) and hexamethylene diamine (HMD),

— step two involves the polymerization (forming long molecular chains) of the raw material to produce a paste (molten polymer) which is cooled and then cut into chips (polymer granulate),

— step three involves the re-melting of the chips, and extrusion of the molten polymer into either filament yarn (bulked continuous filament yarn known as BCF) or staple fibre.

(8) Different companies participate in the various industrial levels in the production chain. Some companies participate at all levels (the integrated companies). In Europe there are three integrated companies. There are ICI, Du Pont and the French company Rhône-Poulenc, all three having large petro-chemical facilities ([1]). Other petro-chemical companies such as the German company BASF are only active in the first two steps of the production chain, i.e. producing caprolactam or nylon salt, and polymerization.

Some companies are only active on the last two steps of the production chain, i.e. polymerization and fibre production. These companies, such as the Italian producers SNIA, Radici and Aquafil, buy in their requirements of caprolactam or nylon salt.

A third group of companies only manufactures fibres, buying in the polymer. These companies are either specialists in certain niches, or are small companies mainly producing commodity fibres. This group of companies mainly produces textile fibre.

One European carpet manufacturer, Beaulieu, (the world's second largest carpet manufacturer) also produces nylon fibres for its own use. It is not, however, capable of producing the entire range of nylon fibre which is requires ([2]).

(9) There was fast growth in the use of nylon fibres until the 1970s and lower growth rates, at least in Europe, thereafter. The overall demand for nylon was growing at around 3 % per year over the last decade and is expected to continue at around this level for the next decade. The lowest growth rate (2 to 3 %) is expected in North America, the highest growth rate (4 to 5 %) in the Asia Pacific region, whilst Europe is expected to have growth of around 3 to 4 %.

The European nylon industry has for some time been characterized by overcapacity at the nylon fibre production level, which has had an impact on the profitability of most of the players.

2. **Relevant product markets**

(10) The proposed concentration has a direct impact on the end-use applications of nylon fibres. The end-uses of nylon fibre must be distinguished because the different applications result in different relevant markets for the various types of nylon fibres produced.

The major groups of end-use applications for nylon fibre are :

— fibres for textile applications,

— fibres for floor coverings (carpets),

— fibres for industrial applications.

([1]) ICI shut its ADN facilities in July 1992 and currently buys in its ADN requirement for the continuing production of HMD. Du Pont has no production of adipic acid (AA) in Europe, and buys this raw material. AA is an ingredient used in many chemical processes. In the production of nylon, it is combined with HMD to make nylon salt.

([2]) Only one other European manufacturer, the Belgian company ITC, has been identified as having even a minimal nylon fibre production capacity.

Both Du Pont and ICI are active competitors in the Community in fibres for carpets and in industrial yarns. ICI is, in addition, present in textile applications with Du Pont being the leading supplier in the neighbouring market for elastane fibres with its Lycra products.

In 1991 in the Community, ICI had a turnover of around ECU [...] (*) (1) million in nylon textile fibres, around ECU [...] (2) million in nylon carpet fibres, and around ECU [...] (3) million in industrial fibres. Du Pont had a turnover of around ECU [...] (4) million in nylon carpet fibres and around ECU [...] (5) million in industrial fibres. Du Pont had negligible sales of nylon textile fibres because it has no Community production. The other nylon sales of Du Pont and ICI in the Community was mainly accounted for by industrial engineering resins. (Du Pont around ECU [...] (6) million, ICI around ECU [...] (7) million.)

Du Pont's worldwide nylon revenue in 1991 was around ECU [...] (8) million, of which around ECU [...] (9) million was in Western Europe.

(11) The fibres for each of these major end-use applications belong to distinct markets. While the nylon polymers used in the manufacture of the different nylon fibres are essentially the same, many of the physical properties, e.g. weight, thickness, softness, durability, tenacity, etc., vary significantly from one group of fibres to another, depending on the end-use for which it is intended. Hence, for exemple, a nylon carpet fibre cannot be used for a textile/apparel application and a textile yarn cannot be used for a typical industrial application. To illustrate these differences, the range of typical nylon fibre decitex (10) depending on the intended end-use is as follows:

textile fibre:	10-150
carpet fibre:	700-2 000
industrial fibre:	1 000-2 000.

In addition to varying decitexes, the nylon polymer may also be modified depending on the intended application to provide for special fibre properties.

The differences in decitex, as well as other key fibre properties required for each end-use, mean that these different fibres are not manufactured on the same equipment.

(12) It is not necessary to decide in this case whether or not there are relevant product markets for nylon fibres for textile applications or for a specific use within textile applications. There is no horizontal overlap between Du Pont and ICI for these products and the acquisition by Du Pont of ICI's nylon fibres for textiles activities does not lead to the creation or strengthening of 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.

(13) Similarly, there is no creation or strengthening of a dominant position in nylon fibres for industrial applications. It can therefore be left open whether there is one or more relevant product markets for nylon fibre in the various industrial end-uses.

Nylon fibres for carpets

(14) There is a relevant product market comprising all nylon fibres used for carpets. The different types of nylon fibre compete within this overall market. ICI's turnover within the Community in this market represents around 20 % of its overall worldwide nylon turnover.

Other fibres used for carpet manufacturing, such as polypropylene, wool, polyester and acrylic are not regarded by the carpet manufacturers as interchangeable or substitutable to a significant extent with nylon carpet fibres, by reason of their characteristics, their prices and their intended use in the manufacturing process.

It appears that nylon fibres produced through both the nylon 6 route and the nylon 6.6 route are largely substitutable for use in carpet manufacturing. Nylon 6 and nylon 6.6 are two different chemical forms of nylon, with a different manufacturing process and different raw materials. Manufacturers generally produce one or the other, not both. Both Du Pont and ICI produce nylon 6.6.

(*) In the published version of the Decision, some information has hereinafter been omitted, pursuant to the provisions of Article 17 (2) of Regulation (EEC) No 4064/89.
(1) Precise figure deleted; between 250 and 300.
(2) Precise figure deleted; between 100 and 200.
(3) Precise figure deleted; between 50 and 100.
(4) Precise figure deleted; between 150 and 200.
(5) Precise figure deleted; less than 50.
(6) Precise figure deleted; between 100 and 150.
(7) Precise figure deleted; between 50 and 100.
(8) Precise figure deleted; between 2 500 and 3 000.
(9) Precise figure deleted; between 350 and 400.
(10) Decitex measures grams per 10 000 metres.

The principal differences in characteristics between the two types of nylon are temperature resistance, surface smoothness, stretch recovery and to some extent low-temperature dyeability. As far as use in carpet manufacturing is concerned, however, these different characteristics are not so significant from a technical point of view as in other end-use applications. Although there is a slight difference in price between the two types of nylon fibre (nylon 6.6 carpet fibre is around 5 % more expensive than nylon 6 carpet fibre), and there are some switching costs in changing from one to the other (for example, arising from changes necessary to dyeing systems), both fibre types would appear to be considered by the carpet industry to be substitutable to a significant extent.

(15) For both nylon 6 and nylon 6.6 fibres, there are two different types of fibres used for the manufacture of carpets, staple fibres and bulked continuous filament (BCF) fibres.

Filament yarns are produced in 'infinite' length via melt spinning and sold as a wound package to the carpet manufacturers. Staple fibres are produced by the same basic melt spinning process, but here the filaments are cut to relatively short lengths and baled for dispatch. However, to be used in carpets, staple fibres must be spun into yarn form in an additional processing step carried out by specialist spinning companies. For the carpet manufacturers, the price of comparable BCF and spun staple fibre is essentially the same. Because of the simpler initial production process, staple fibres are sold by the fibre producers to the spinners at prices which are generally cheaper than BCF fibres. The BCF fibres are ready to use by the carpet manufacturers, and are sold directly to them.

Experience built up over the years and installed equipment have led carpet manufacturers to have a certain preference for either BCF or staple fibres. However, the importance of the differences between BCF and staple has declined over time as technical improvements have led to greater uniformity of BCF yarns. Today, most carpet types can be made from either BCF or staple. There remain, however, some types of carpet, for example solid shade velours, where BCF cannot yet fully compete with staple due to its lack of uniformity, and thus staple is preferred.

It is considered for the reasons set out above that for carpet manufacturing nylon staple fibre and BCF belong to the same relevant product market.

(16) Du Pont states in its notification that polypropylene carpet fibres should be considered as substitutable for nylon carpet fibres.

The Commission's investigation, however, shows that for the carpet manufacturers there is no significant substitutability between nylon carpet fibres and polypropylene carpet fibres.

(17) The main reasons for the use of nylon carpet fibres derive from their distinct inherent characteristics *vis-à-vis* other fibres which give specific advantages both for manufacturers in terms of processing and for the final consumer in terms of performance.

The most significant distinct characteristics of nylon fibre are :

— dyeability,

— appearance retention,

— excellent resilience and abrasion resistance,

— safe flammability.

(18) Unlike polypropylene fibre, nylon carpet fibre can be both dyed and printed during the process of carpet manufacturing. In this way, for example, large runs of undyed carpets can be produced which can then be dyed as required in response to customer demand. This leads to high flexibility, and efficiencies in production, stock and in distribution. Because of this dyeability, furthermore, nylon carpet fibres can be printed with different colours during manufacturing, giving unlimited pattern choice. These advantages are particularly relevant in the production of tufted carpets, this being the most widely produced form of carpet. Colour and design are amongst the most important parameters by which carpet manufacturers can differentiate their products.

This dyeability characteristic of nylon fibre has a major implication for the business of a carpet manufacturer. It enables the manufacturer to determine the value added by colouring and printing, these being the main means of product differentiation for the manufacturer. The value added in the colouring and/or printing stages of production is much higher than in the tufting or carpet construction stage. Even for a simple plain-coloured tufted carpet, for example, the dyeing costs are around two-thirds higher than the tufting costs, according to Du Pont estimates. If a pattern is to be introduced, then there is further significant value added at this stage, this being much more complicated than plain-dyeing.

The efficiencies in stocking and distribution costs resulting from this dyeability characteristic of nylon carpet fibres arise from the possibility to stock only the undyed (white) fibres, as opposed to hundreds of potential colour variants, and/or the possibility to stock undyed carpets which can be dyed and printed to order, as opposed to the entire range of carpets available for sale. This enables the manufacturer to react quickly ('just in time') to specific orders without incurring high stocking costs. This allows much leaner distribution with short lead times.

Polypropylene carpet fibre is capable of use only in a pre-dyed form since colour can only be added to the molten polymer during fibre production. Once the fibre is produced, it cannot accept further colour processing because of its chemical make-up.

(19) The other specific characteristics of nylon fibre, which determine the appearance and wearability of the final product, also account for the use of nylon fibre in higher quality carpets. For the most significant performance and appearance requirements, nylon carpet fibres have the best balance of properties. Nylon fibre is accordingly considered by the carpet manufacturers to have the best performance/cost ratio of all carpet fibres in the medium to high price range of carpets.

(20) Because of the excellent abrasion resistance and resilience, and good appearance retention, nylon carpets generally wear better and longer than polypropylene carpets. For the contract market, it is important for most applications to have hard-wearing carpets which conform to flammability standards. The characteristics of nylon fibre compared to those of polypropylene fibre in this respect make nylon fibre the preferred fibre for most contract use in the Community.

(21) Almost all the carpet manufacturers who have responded to the Commission's enquiries to date state that nylon carpet fibre cannot be substituted by polypropylene or other carpet fibres either at all or only to limited extent (21 out of 23 manufacturers, the remaining two unclear). A significant number of these manufacturers which were contacted produce both nylon and polypropylene carpets. These manufacturers which use both types of fibre state that the different fibres are geared to specific parts of the carpet market in view of their specific characteristics (e.g. nylon fibre used for, *inter alia*, the contract market and for printed carpets, polypropylene fibre for the low-end residential market).

(22) The overwhelming majority of the carpet manufacturers contacted did not consider it feasible to substitute their current and anticipated nylon fibre use by polypropylene fibre. The reasons cited include :

— using only polypropylene fibre would not permit the manufacturer to cover an adequate range of the carpet market,

— using only polypropylene fibre would mean the loss of those segments where the highest value-added is achieved,

— the high capital investment in dyeing and printing facilities could not be recovered because this machinery cannot be used with polypropylene fibres which are not dyeable,

— higher production costs arising from the loss of manufacturing flexibility. Since nylon can be produced in an undyed form, and then coloured and printed to order, this achieves significant production efficiences impossible with polypropylene fibre,

— higher stocking costs, again arising from the different dyeability characteristics. Because polypropylene fibre is pre-dyed, a complete range of colours must be stocked.

Only three carpet manufacturers of those contacted state that there would be no technical difficulty for them to replace their current nylon fibre use by polypropylene fibre. Two of these, however, go on to state that this would involve a very considerable change from their current product profile.

(23) It follows from the above that carpet manufacturers are in general not able to switch between nylon and polypropylene fibres in reaction to significant changes in the supply conditions of either fibre. For two products to be regarded as substitutable, the direct customer must consider it a realistic and rational possibility to react to, for example, a significant increase in the price of one product by switching to the other product in a relatively short period of time. Each product must be a reasonable alternative for the other in economic and technical terms. In this context, industrial customers will usually make an objective evaluation of alternative inputs.

In the present case, for example, the carpet manufacturers can and do switch in a relatively short period of time between the use of staple nylon fibre and nylon BCF, and between fibres from the nylon 6 route and fibres from the nylon 6.6 route. In contrast with this they do not switch back and forth between nylon and polypropylene fibres.

(24) There is a large price difference between nylon fibres and polypropylene fibres in general. A typical average nylon fibre would cost almost twice as much as a typical polypropylene fibre (the polypropylene : nylon fibre price ratio is around 1 : 2,13 based on 1991 data ; the ratio was 1 : 1,87 in 1987).

Despite this price gap, nylon fibre remains so far the most widely used fibre in carpet manufacturing. The cost of fibres in general accounts for between 25 and 40 % of the ex-factory price of carpets for the manufacturers. Since fibre cost is so significant for the carpet manufacturer, the fact that nylon fibre has not been displaced by polypropylene fibre can therefore only be explained by the non-substitutability of the two fibres arising from their different specific characteristics.

(25) Since polypropylene fibre has been available since the early 1970s, it could have been expected that if it was possible or rational to replace nylon fibre by polypropylene fibre, this would have already taken place to a significant extent.

This is confirmed by a detailed analysis of the historical development of the use of different fibres in carpet manufacturing. Over the last twenty years, the use of polypropylene fibres has grown to around 36 % of total carpet fibre use, in an expanding overall carpet market. In contrast, nylon fibre, which accounted for around 40 % of total carpet fibre use in the early 1970s, actually increased to 49 % by 1979. There was a decline in the overall share of nylon to 41 % by 1984. Subsequently the share of nylon has remained almost stable (a decline of 1,4 % in the period 1984 to 1990).

Volume (in 1 000 tonnes) and % in total fibre use

	1984		1985		1986		1987		1988		1989		1990	
Nylon	193	41 %	197	41 %	198	41 %	213	40 %	219	40 %	234	39 %	239	39 %
Polypropylene	128	27 %	134	28 %	149	31 %	171	33 %	189	35 %	214	36 %	220	36 %
All fibres	465		466		477		526		545		593		609	

(26) The overall use of carpet fibre grew substantially throughout the last 15 years. Over the whole period, nylon fibre has been the most widely used fibre. Its use grew from around 170 000 tonnes in the early 1970s to around 240 000 tonnes in 1990. In the period from 1984 to 1990, where the share of nylon fibre of total fibre use was almost stable, the volume of nylon fibre used grew by some 23 % from around 195 000 tonnes.

(27) Over the last 15 years, however, polypropylene fibre has eroded the overall shares of all fibres used in carpets, although this development has slowed down from 1984 onwards. Overall, it is expected that the trends in the use of the various carpet fibres observed over the period 1984 to 1990 will continue in the foreseeable future. The estimates of the parties show that the use of polypropylene fibre will grow at a rate of around [...] (1) per year, whilst the use of nylon fibre will grow at around [...] (1) per year between now and 1995. No significant substitution of nylon fibre by polypropylene fibre is therefore expected.

(1) Precise figure deleted ; less than 3 %.

(28) The general price development in the Community of nylon fibre and polypropylene fibre for use in carpets over the last five years has been checked. There is no indication that the polypropylene fibre price has a significant influence on the nylon fibre price. Polypropylene fibre prices for carpets have fallen by between 10 % and 11 % in nominal terms over the last five years, whereas nylon fibre prices for carpets have increased in nominal terms by between 3 and 4 % over the same period. Since during this period the share of nylon fibres in total carpet fibre usage remained largely constant, these figures do not indicate significant positive cross-price elasticity between nylon and polypropylene fibres for carpets.

This analysis of the comparative price development of nylon and polypropylene carpet fibre prices is based on the average prices of the main fibre producers. Both nylon carpet fibres and polypropylene carpet fibres are differentiated products, rather than homogeneous products. Such an analysis therefore cannot result in a precise measurement of cross-price elasticity since the average prices depend to a certain extent on the product mix sold.

The figures however show a tendency. Furthermore, the object of the calculation is to reflect the dynamic of competition between nylon carpet fibres and polypropylene carpet fibres. Both types of fibre are continuously changing and improving, and the product mix therefore changes over time. Any comparison of the price development must reflect this dynamic.

3. Relevant geographic market

(29) It is considered that the relevant geographic market for nylon carpet fibres is the Community.

The Community carpet manufacturers are concentrated in Belgium, Germany, the UK, the Netherlands and France. The nylon carpet fibre producers are based mainly in Germany (Du Pont, ICI, Akzo), the UK (ICI), France (Rhône-Poulenc) and Northern Italy (Snia, Radici, Aquafil). The carpet manufacturers buy, and the fibre producers sell, throughout the Community. Du Pont and ICI, for example, sell their carpet fibres to all Member States where there is carpet production. All the fibre suppliers sell to carpet manufacturers in the five most significant carpet producing Member States (which account for around 90 % of all Community nylon carpet fibre consumption).

On the other hand, the evidence shows that the market is not wider than the Community. There are relatively low imports (less than 10 %), negligible exports and consequently relatively little mutual inter-penetration between the Community and other areas such as North America and the Far East. There has been no significant change in the export/import pattern over the last decade. There is no indication that this will change in the foreseeable future.

The main reason for this low inter-penetration is that a close relationship is required between the fibre manufacturers and their customers. This arises mainly because of the necessity for security of supply of fibre by the carpet manufacturer, and the close working relationship between fibre manufacturers and carpet manufacturers in the development of specific fibres and carpets. There are, furthermore, additional transport costs for overseas shipments and also an import duty of 9 % into the Community.

4. Structure of the nylon markets

(30) Over the last decade, there has been no significant entry into the overall Community nylon industry or into any of the nylon fibre markets. During this period, exit from and consolidation within the industry has continued.

4.1. *Nylon fibres for carpets: competitors and market shares*

(31) The competitors in the nylon carpet fibre market and an indication of their market shares in terms of value of sales in the Community in the last three years are as follows (1):

	1989 (1)	1990 (1)	1991
	%	%	%
Du Pont	...	...	... (2)
ICI	...	...	... (2)
	...	...	43
Rhône-Poulenc/Snia		20-25	
Aquafil			
Radici			
Akzo		5-10 each	
Allied			
Others			
	100	100	100

(1) Precise figures deleted.

(2) Precise figures deleted; between 20 and 25 %.

(1) Total production in the Community was around 250 000 tonnes in 1991. Capacity is estimated at around 320 000 tonnes, the rate of utilization of capacity being similar for all producers.

In a market where products are differentiated in terms of price and quality, the appropriate method of calculation of market shares has to be based on value rather than volume. In this way, high value items are given their correct weight relative to low value items. A calculation based on volumes would not reflect the real market position of the players.

Furthermore, although relevant in any assessment of market power, it would be incorrect to include captive production in market share calculations because these quantities are not available on the market. In the present case for example the other carpet manufacturers cannot buy nylon carpet fibres from the backward integrated carpet manufacturer, Beaulieu. Beaulieu's captive production is therefore excluded from the above figures.

The total value of the Community nylon carpet fibre market was around ECU 750 million in 1991.

5. Impact of the concentration

5.1. *Position of Du Pont after the concentration*

(32) By acquiring ICI's nylon business, Du Pont would increase its market share in the EC from around [...] (1) to 43 % based on 1991 figures. This is about twice that of the next competitor, Rhône-Poulenc/Snia. Overall, the other competitors are smaller. Over the last three years, Du Pont's market share declined by [...] (2) and ICI's by [...] (2). It cannot be excluded that this decline in market share would continue after the concentration.

(33) Du Pont and ICI are the leading companies in terms of quality of products and technological development. Through its research programme, for example, ICI has developed the largest selection of carpet yarns and fibres in the world, offering to the carpet manufacturers enormous variety of decitexes, lustres, cross-sections and dye variants. Both ICI and Du Pont incorporate technical support into their mainstream development activity. They are recognized in the industry as working with manufacturers, wholesalers and retailers to a much greater extent than their other competitors. This technical collaboration involves, *inter alia*, the joint development of new fibres and carpets, and the examination of new production methods for carpets.

(1) Precise figure deleted; between 20 % and 25 %.
(2) Precise figure deleted; less than 5 %.

The level of research and development of both Du Pont and ICI is above the nylon industry average. Du Pont for example spends around [...] (3) of sales on product development work and a further [...] (3) to [...] (3) on technical service to assist customers in product enhancement and differentiation.

(34) Both Du Pont and ICI pursue a strategy of selling high value premium fibres, as well as selling commodity fibres. They are the main competitors in the industry to market brands at the level of retailers and final consumers through, for example, country-wide advertising campaigns. [...] (4) ICI is Du Pont's closest competitor overall. Both companies sell a wide variety of differentiated products and ICI has been Du Pont's most likely source of competition in quality of product and innovation in the past.

(35) Both Du Pont and ICI are integrated nylon fibre producers, i.e. they cover all the manufacturing steps in the claim to produce nylon fibre from the base chemicals to the end fibre. On the basis of Du Pont's figures, being an integrated producer is a competitive advantage. By acquiring ICI, Du Pont would be able to source its adipic acid requirement internally. This would improve Du Pont's cost base.

Du Pont is the lowest cost producer in the world, because of the scale of its production in particular in the US and since its proprietary route to nylon via butadiene is the cheapest.

(36) The strength of Du Pont in the nylon carpet fibre market in the Community after the proposed concentration has to be assessed in the context of Du Pont's global position in the nylon industry.

Du Pont is one of the world's largest chemical companies. The nylon facilities of Du Pont in the different regions of the world can rely on its large US based research and development activity.

(37) Du Pont is therefore already a strong competitor in the Community nylon carpet fibre market and it would be strengthened by the acquisition of ICI's nylon business.

(3) Precise figure deleted.
(4) Business secret deleted.

5.2. Position of competitors

(38) The most significant competitor of Du Pont and ICI in the nylon carpet fibre market to date is Rhône-Poulenc. Rhône-Poulenc and the Italian subsidiary of Fiat, Snia, have recently entered into an agreement to combine their nylon carpet fibre activities in a joint-venture company. Both companies considered that this agreement was necessary to attain a size which would enable them to better competete in the market.

The combined product range of Rhône-Poulenc/ Snia is not as large as that of Du Pont/ICI. This is largely because Rhône-Poulenc and Snia in the past have carried out relatively limited product development and research. Rhône-Poulenc/Snia, however, now has a strategy of focusing its future growth on the higher segments of the market. The joint-venture arrangement will provide an improved sales base in which to exploit this development.

The Rhône-Poulenc/Snia business can justify a higher level of investment than was possible in the past for the two partners alone. It would take a considerable time, however, to significantly broaden the existing product range in this way.

Furthermore, Rhône-Poulenc is also a fully integrated producer of nylon fibres, based on the butadiene route which is the cheapest. Rhône-Poulenc produces all its adiponitrile requirement in a 50 : 50 joint venture with Du Pont. Despite the significance of adiponitrile in the nylon chain, there is no indication that this cooperation between Rhône-Poulenc and Du Pont has influenced to a significant extent the competitive behaviour of Rhône-Poulenc *vis-à-vis* du Pont.

(39) There are three other significant competitors which each presently have around 10 % of the Community nylon carpet fibre market.

The Italian company Aquafil has grown significantly over the last few years, its market share increasing by around one third over the last three years. A large proportion of its sales are of high quality fibres.

Another Italian company, Radici, is a supplier of commodity fibres. Its sales and market share have also been growing over the last three years.

The Dutch company Akzo, which is one of the Community's largest chemical companies specializes in selling high quality fine nylon yarns at the top end of the market. It has maintained market share in this segment.

(40) There is some import penetration from the large US nylon producer Allied Signal, which has less than 5 % of the market. There is no indication, however, that the other large US nylon producers intend to export production to the Community in the foreseeable future.

(41) In general terms, the competitors do not at present cover the whole range of fibres supplied by Du Pont and ICI. In the short to medium term these competitors are not likely to be able to develop a significantly broader range of high quality fibres across the board. The range of fibres which both Du Pont und ICI are currently able to offer has been built up over a long time, and is a result of research and development justified by the large sales base of both companies.

Product differentiation is a key element of competition in this market. The existence and further development of a large variety of nylon fibres is very important for the Community carpet manufacturers since this is a factor which enables them in turn to differentiate their products. The success of the Community carpet manufacturers, at least in the medium to high end of the overall carpet market, depends on their ability to offer a broad range of different products.

5.3. Position of customers

(42) The customers are the European carpet manufacturers. There is a group of large companies. The largest company, Beaulieu, which is based in Belgium, has a turnover of around ECU 1,1 billion in 1990. There are three carpet manufacturers in the Community in the range of ECU 250 million to ECU 350 million turnover retail on 1990 figures. There are eleven manufacturers in the range of between ECU 100 million and ECU 250 million. The remaining carpet manufacturers are small or medium-sized companies.

(43) To a certain extent, when a carpet manufacturer chooses a particular fibre to make a particular carpet in a collection, the manufacturer is committed to that fibre for that carpet at least for the life of the collection.

The cost of launching a new carpet range involving design, the production and distribution of sample books to all outlets, and promotion, is a significant expense for carpet manufacturers. When a carpet manufacturer introduces a new range of carpet, therefore, this range would usually have a life of between three and seven years. The construction of a carpet is made with regard to the technical properties and attributes of the specified fibre. Without using the specified fibre, the carpet manufacturer cannot produce the same carpet as that sold in accordance with sample books.

The choice of a particular fibre and a particular supplier is therefore a significant one for the carpet manufacturer. Manufacturers therefore follow a strategy of multiple supply as much as possible. This can be expected to continue after the proposed concentration, since it is not in the manufacturers' interest to become dependent on any one supplier. It may be, therefore, that over time, where a manufacturer currently buys fibres from both Du Pont and ICI, there will be an incentive to shift some of this demand to another supplier.

(44) The parties have also submitted that the carpet manufacturers have the option to integrate backwards into nylon fibre production, and that this is a potential source of buyer leverage. In the Community, Beaulieu and ITC of the carpet manufacturers have integrated backwards into nylon fibre production. Beaulieu is by far the largest European carpet manufacturer.

The only other Community carpet manufacturer amongst the larger producers so far to decide to install come captive fibre production facilities is the Belgian Balta/ITC group. This production facility was installed in 1984. It is now run at full capacity.

Although the other carpet manufacturers contacted have no current plans to install their own fibre production facilities, this possibility cannot be excluded in the medium to long term.

5.4. *Indirect competitive pressure from other fibres at retail level*

(45) Du Pont would achieve, with the proposed acquisition, a strong position in the market for nylon carpet fibres. Nonetheless there is indirect competitive pressure on Du Pont, as on all nylon fibre producers, arising from the retail price of carpets made from other fibres, in particular polypropylene fibres.

(46) For the residential customer in particular, it is difficult to distinguish between polypropylene carpets and nylon carpets. Consumers make their buying decisions for carpets on the basis of four main criteria, these being price, colour/design, intended use, and quality. Price, however, is the most important factor generally.

Prices of carpets in general vary enormously. There are however identifiable price categories at which nylon and polypropylene carpets are sold. These vary to a certain extent from one Member State to another. Polypropylene carpets so far have been mainly sold in the lowest price category. This category also contains the cheapest nylon carpets. In the Medium price category, the carpets sold have been mainly nylon carpets but polypropylene carpets are now making inroads. In the higher price category, very few polypropylene carpets have been sold in the past.

There is therefore direct competition between polypropylene carpets and nylon carpets in the main segments of the overall carpet market. This degree of overlap at retail level results in significant indirect competitive pressure on the prices of carpet fibres. This indirect pressure amounts to a significant constraint on the competitive behaviour of the nylon fibre suppliers.

5.5. *Effect of the proposed concentration on the nylon carpet fibre market*

(47) The Community nylon carpet fibre market is for the time being competitive. There is price competition and there is in particular competition with regard to quality and innovation. As a result of the proposed acquisition of ICI's nylon business, Du Pont would be the strongest player in the Community nylon carpet fibre market. It is true that the position of the remaining competitors, the possibilities for the carpet manufacturers to switch suppliers over time, together with the significant indirect competitive pressure from polypropylene carpets on the retail level, amount to some constraint on Du Pont's freedom of action. Nevertheless, the strengthening of Du Pont in the Community nylon carpet fibre market leads to a considerable reduction of competition, in particular with regard to the competition in product development. Product differentiation resulting from continuing innovation is one of the driving forces of this market. Competition in product development between Du Pont and ICI in the past has been an important source of innovation in the Community. Consequently, it is reasonable to assume that the position of Du Pont would be such as to enable it to act independently of its competitors and of its customers.

(48) Du Pont has recognized the Commission's concerns in this respect and in order to meet these concerns Du Pont has accordingly modified its original concentration plan by entering into the following undertakings *vis-à-vis* the Commission.

'Du Pont undertakes that, as soon as practicable after the completion of the notified transaction and in any event not later than 30 days after the completion of the notified transaction, Du Pont will take necessary steps to enter into good faith negotiations with interested third parties with regard to the following arrangement and will conclude such arrangement as soon as practicable but no later than [...] (1) after the completion of the notified transaction. These periods may be extended with the agreement of the Commission.

1. Du Pont will reserve capacity to produce up to 12 000 tonnes per annum of nylon staple fibre representing a cross-section of ICI's current product range for the benefit of an independent third party. So as to ensure improved competition, such a third party must be a supplier of nylon fibres and not a carpet producer.

2. Du Pont will manufacture up to 12 000 tonnes per annum of such nylon staple fibre as may be specified by such third party for a period of five years renewable by the selected candidate. Such products will be sourced from the facility best suited to meeting such third party's requirements. The fee to be paid for such fibre products will be based on a polymer pricing formula plus a fibre conversion fee as agreed between Du Pont and the third party. Such fee will be based on take or pay principles common in similar manufacturing arrangements.

3. Du Pont will, on terms and conditions as agreed between Du Pont and the third party, agree to transfer to such third party a free-standing carpet research and development facility comparable in terms of quality to those currently existing in Oestringen and Geneva and appropriate to the business transferred. Such facility, which will be staffed with competent technical personnel at least half of whom should be from ICI's Oestringen facilities, will be at a location chosen by the third party. Du Pont will, on terms and conditions as agreed between Du Pont and the third party, take all reasonable steps to encourage the relevant ICI personnel to take up employment with the third party.

4. Du Pont will, on terms and conditions as agreed between Du Pont and the third party, take all reasonable steps to encourage the competent sales personnel familiar with the business being transferred to take up employment with the third party.

5. Du Pont will, on terms and conditions as agreed between Du Pont and the third party, license exclusively or assign to the selected third party ICI's "Timbrelle" trademark.

Any dispute between Du Pont and the selected third party arising out of the implementation of these undertakings will be submitted to independent arbitration to be mutually agreed between Du Pont and such third party.'

These undertakings have been taken into account in the Commission's assessment of the effect of the proposed concentration. The undertakings will immediately enable a third party to replace ICI partially as a supplier of high quality fibres by the transfer of the equivalent of [...] (2) of the existing staple fibre production of ICI at its main nylon carpet fibre facility at Oestringen, in Germany. This third party will be able to maintain and build on this position in the segment of the market which is closest to that of Du Pont in terms of quality through the research and development facility and development and support expertise also to be transferred. This would significantly improve the competitiveness of the third party, in particular as regards its product range and future product development. These undertakings therefore will substantially reduce the likelihood that Du Pont could be able to determine the degree of product development and innovation in the market.

CONCLUSION

(49) The proposed concentration, amended by the inclusion of the undertakings would not therefore create a dominant position on the EC nylon carpet fibre market as a result of which effective competition would be significantly impeded in the common market within the meaning of Article 2 (3) of the Merger Regulation,

HAS ADOPTED THIS DECISION:

Article 1

The proposed acquisition by Du Pont of ICI's nylon business is declared compatible with the common market.

Article 2

This Decision is subject to the obligation that Du Pont fulfils the undertakings which it has entered into *vis-à-vis* the Commisison.

(1) Precise time deleted.

(2) Precise figure deleted; around half.

Article 3

This Decision is addressed to:

E.I. du Pont de Nemours and Company,
c/o Cleary, Gottlieb, Steen & Hamilton,
23 Rue de la Loi,
B-1040 Brussels.

Done at Brussels, 30 September 1992.

For the Commission
Leon BRITTAN
Vice-President

II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION
of 12 November 1992
declaring a concentration to be compatible with the common market
(Case No IV/M.222 — Mannesmann/Hoesch)
Council Regulation (EEC) No 4064/89
(Only the German text is authentic)

(93/247/EEC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings [1], and in particular Article 8 (2) thereof,

Having regard to the request of the German Bundeskartellamt of 29 June 1992 seeking referral of the case in accordance with Article 9 (2) of the above Regulation,

Having regard to the Commission's decision of 14 July 1992 to initiate proceedings in this case,

Having given the undertakings concerned the opportunity to make known their views on the objections raised by the Commission,

After consultation with the Advisory Committee on Concentrations [2],

Whereas :

I. THE NOTIFIED OPERATION

(1) Mannesmannröhrenwerke AG (MRW) and Hoesch AG (Hoesch) intend to bring together their precision steel tube business through the establishment of a new 50:50 joint venture (JV) called MHP Mannesmann Hoesch Präzisrohr GmbH (MHP). MRW will contribute its works at Brackwede, Holzhausen, Remscheid and Wickede, as well as its 75 % shareholding in Robur Buizenfabrik at Helmond in the Netherlands. In addition, the Mannesmannröhrenwerk Sachsen GmbH (MRS) works, making precision steel tubes, will become a dedicated production facility for MHP. Hoesch will contribute its works at Hamm, together with its 100 % shareholding in Schulte Rohrbearbeitung GmbH at Drensteinfurt.

(2) With regard to non-precision steel tubes, Hoesch will in turn transfer ownership of its 100 % owned subsidiary, Hoesch Tubular Products Corporation, USA (HTP) to MRW and will give MRW a 50 % shareholding in its fully owned subsidiary, Gebr. Fuchs GmbH at Siegen (Fuchs). As such, Fuchs will become a 50:50 JV of MRW and Hoesch. That part of Hoesch's works at Hamm producing non-precision steel tubes and which is to be transferred to MHP will become a dedicated production facility for MRW. Hoesch has no other non-precision steel activities.

(3) MRW's existing non-precision tube business, as well as its steel tube subsidiaries in Brazil and in Turkey, will not be part of the transaction. MRW

[1] OJ No L 395, 30. 12. 1989, p. 1 ; republished in OJ No L 257, 21. 9. 1990, p. 13.
[2] OJ No C 128, 8. 5. 1993, p. 3.

and Hoesch (through Krupp) each have a share of 11 % in the small German steel producer, NMH Stahlwerke GmbH. That company has a tube-making subsidiary, Rohrwerke Neue Maxhütte GmbH [...] [1]. Those steel tube activities are not part of the transaction either.

(4) Since the above operations are carried out by the same parties and relate to the same sectors of an industry, with each operation representing part of an overall agreement between the parties to restructure their steel tubes activities, they have to be considered a single concentration within the meaning of Article 3 of Regulation (EEC) No 4064/89 (hereinafter known as 'the Merger Regulation'). Therefore the creation of the two joint ventures, i.e. MHP and Fuchs, and the acquisition by MRW of sole control of HTP, represent a single concentration for the purposes of the Merger Regulation.

II. THE PARTIES

(5) MRW is active in the production, finishing and distribution of steel tubes. It is a 75 % subsidiary of Mannesmann AG. The latter is a diversified German group with activities in the areas of mechanical engineering and plant construction, information systems, electronic engineering, automative parts, the production and finishing of iron and steel products, and the provision of related services. The other 25 % of MRW is owned by Thyssen Stahl AG, a German steel producer, which is not a party to the present operation.

(6) Hoesch is also a German producer of metal and in particular of steel and iron products, and engages in a very wide range of activities connected with those domains. Hoesch will be acquired by Krupp GmbH. The project has already been cleared under the ECSC Treaty [2], but does not fall under the Merger Regulation as far as the non-ECSC products are concerned.

III. CONCENTRATIVE JOINT VENTURES

Joint control

(7) MRW and Hoesch will each hold 50 % of the shares of MHP and Fuchs. They will have equal voting rights and an equal number of shareholder representatives on the supervisory boards and in the shareholder committee of MHP. The management of each JV must submit all major business decisions to either the supervisory board (Fuchs) or to the shareholder committee (MHP) for prior approval; those business decisions include business, price and distribution policy as well as investment, financial and personnel planning.

Therefore MHP and Fuchs will be jointly controlled within the meaning of Article 3 of the Merger Regulation.

Autonomous economic entity

(8) MHP will bear its own responsibility for its business activities. The parties have agreed to provide MHP with the necessary financial resources for its business development in proportion to their shareholdings, if these cannot be met out of its own resources and unless more favourable financing can be found elsewhere.

(9) Fuchs is at present a business performing all the functions of an autonomous economic entity. This will remain so notwithstanding the change in its ownership arrangements. The parties have agreed that Fuchs shall continue as an independent company with its own market strategy and that the necessary financial resources shall be supplied for its development, as for MHP.

(10) The steel inputs of both joint ventures will be nearly fully supplied by their parents. Steel accounts for over 80 % of the material costs and for about 25 to 40 % of the total production costs. MHP will probably effect a substantial part of its sales (roughly 40 %) via its parents' trading companies. Furthermore, account must be taken of the existence of mutually dedicated production facilities (non-precision tubes being made by MHP on behalf of MRW and all of MRS' output of precision steel tubes being produced on behalf of MHP).

(11) Although there will remain substantial commercial relationships between the parents and the JVs, particularly for MHP, these are insufficient to rebut the overall conclusion that MHP and Fuchs will operate as fully functioning JVs. It has to be taken into account that in the steel industry vertical integration is normal and to a certain extent necessary.

(1) In the published version of the Decision, some information has been omitted, pursuant to the provision of Article 17 (2) of Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets. However, for a better understanding of the text, some general information has been given in a footnote in those cases where it was possible to do so without violating the non-disclosure requirement for business secrets.

(2) Commission Decision of 15 May 1992 (unpublished).

All large European competitors such as British Steel, Usinor and ILVA are fully integrated groups. They supply their tube subsidiaries with steel. They also act as traders for steel products. Moreover, the value added by the JVs to the steel inputs provided by the parents is substantial.

(12) As MHP and Fuchs will be provided with substantial assets and sufficient financial resources and their commercial relationships with their parents do not go beyond normal industrial practice, both JVs must be considered fully functioning autonomous economic entities within the meaning of Article 3 (2) of the Merger Regulation.

Absence of coordination of competitive behaviour by independent undertakings

(13) Hoesch will transfer all its precision steel tube activities to MHP. As regards non-precision steel, it will transfer its 100 % owned subsidiary HTP to MRW and grant a 50 % stake in Fuchs to MRW. After completion, Hoesch will have no other interest in the steel tube markets than through its shareholdings in both JVs. Given Hoesch's interest in the supply needs of both JVs and the existing overcapacity in steel markets, it makes no commercial sense for Hoesch to seek to re-enter the steel tube markets.

(14) MRW will remain active in the markets of the JVs. This is particularly true with regard to non-precision steel tubes, since MRW has extensive interests outside Fuchs. With regard to precision tubes MRW will maintain only minor interests outside MHP. These are :

— its production capacity in MRS, which is nevertheless dedicated to MHP,

— its interest in Röhrenwerke Neue Maxhütte, which is a relatively small producer, and

— its majority shareholdings in Brazilian and Turkish steel tube producers. Both have negligible sales in the European Community.

(15) The different nature of the interests of Hoesch — which will withdraw from the tube markets — as compared with MRW, which retains substantial interests in these markets, is reflected in the business guidelines (Geschäftsordnung) for the shareholders committee of MHP and in the partners agreement between MRW and Hoesch with regard to Fuchs.

(16) Although both Mannesmann AG and the future Krupp/Hoesch group are important steel producers, it should be noted firstly that Mannesmann absorbs nearly all its own production and secondly, that the two are almost exclusively active in different product markets, namely tube rounds (pre-tubes) for Mannesmann and flat products (hot-rolled wide strip) for Krupp/Hoesch. Consequently, the impact on competition in free markets upstream, which are already very small in size given the degree of vertical integration in the industry, is not significant.

(17) The upstream product differentation is also reflected in the supply agreement between the parents and the JVs ; MRW will supply tube rounds (pre-tubes) and squares whilst Krupp/Hoesch will provide hot-rolled wide strip.

(18) Consequently, the creation of the joint ventures will not give rise to the coordination of the competitive behaviour of independent undertakings within the meaning of Article 3 (2) of the Merger Regulation.

(19) In conclusion, both MHP and Fuchs are to be regarded as concentrative JVs within the meaning of Article 3 (2).

IV. COMMUNITY DIMENSION

(20) The aggregate worldwide turnover of the parties in 1991 exceeded ECU 5 000 million (Mannesmann ECU 13 025 million, Hoesch ECU 4 929 million). Both parties have a Community-wide turnover of more than ECU 250 million. The parties do not achieve more than two-thirds of Community-wide turnover within one and the same Member State. The operation has therefore a Community dimension within the meaning of Article 1 of the Merger Regulation.

V. COMPATIBILITY WITH THE COMMON MARKET

A. The steel tube industry

(21) The steel tube industry produces a wide variety of tubes for a range of applications, using different production procedures. Tubes range in size from fine tubes with a diameter of 1 mm up to large tubes with a diameter of more than 1,60 m. The weight of a tube varies correspondingly between only some grams and more than five tonnes per metre length.

(22) In general, steel tubes can be divided into two main groups, namely precision and non-precision tubes. The latter are also called trade and transport tubes. Precision tubes can be distinguished from non-precision tubes primarily through their dimensional accuracy. The necessary tolerances can be achieved either directly through the production process or alternatively through using a non-precision tube as a pre-tube which is subjected to further production steps.

(23) Non-precision tubes can be subdivided according to their application : thus, line pipes are used for the transport of gases and fluids, smooth pipes are mainly employed as construction elements in engineering and steel construction, threaded pipes are used in household installations, boiler and plant pipes are found in power stations and in the chemical and petro-chemical industry, oil-drilling pipes are used in the exploration and drilling for oil and gas, and hollow-section tubes are utilized as construction elements in engineering, motor vehicle construction and structural engineering. Seamless or welded tubes can be used to make the different tube types. Welded tubes are made from flat steel products, whereas seamless tubes are made from tube rounds. Welded tubes are generally cheaper than seamless tubes. Currently, seamless tubes can be replaced by welded tubes for around 85 % of applications. This percentage is increasing continuously due to technological progress and, above all, improved welding techniques. Consequently, the parties consider that seamless and welded tubes do not give rise to separate product markets. To a certain extent different production methods (including cold treatment) and different welding processes can be applied. A wide range of technical standards have to be satisfied corresponding to the specific field of application.

B. Precision steel tubes

1. *The relevant product market*

(24) Precision steel tubes are different from non-precision steel tubes in several respects : the production process (cold treatment of the pre-tubes), the degree of tolerance, and in particular the characteristics, the fields of application and the price. The parties have estimated that the overlap between precision and non-precision steel tubes amounts to only 5 % by volume. The parties consider that precision steel tubes as a whole give rise to a single relevant product market.

(25) It might be possible further to subdivide the market for precision steel tubes into (in particular) :

(i) seamless and welded precision tubes with special characteristics (e.g. DIN 2391 and 2393) ;

(ii) Other welded precision tubes (DIN 2394 and 2395).

(26) Despite existing differences the two precision tube segments are deemed to belong to a single relevant product market. Of importance for this view is that customers in both market segments are the same (vehicle construction and engineering). Those customers are able to determine the scope for the substitution of more basic precision tubes for high-value tubes. The inclusion of both segments in a single relevant product market seems justified since it is possible to move smoothly from on into the other without specific breakpoints.

(27) However, the precise market definition can remain open, since, if a narrower approach is taken, the competitive impact on neighbouring markets still requires assessment and in the present case this does not lead to a materially different conclusion.

2. *Geographic reference market*

(28) On the basis of the given information it can be assumed that the geographic reference market is almost certainly at least Community-wide. This view is supported by the high level of mutual market penetration between Member States as well as the absence of significant price differences. The observation would appear to be equally valid for Member States having no significant steel industry.

3. *Competition assessment*

(29) The combined Community market share of the undertakings concerned is below 10 %. If a narrower product-market definition is adopted for precision steel pipes with high specifications the Community market share still does not exceed 25 %. In Germany the undertakings have a combined market share of approximately 25 %, rising to ... [1] for precision pipes with high specifications.

(30) Even if this very narrow definition of product and geographic market is adopted, the concentration cannot be expected to lead to the creation or strengthening of a dominant position. On the German market there are a number of domestic and foreign producers with significant market shares. Having regard to present and future competitive pressure from other foreign suppliers, as well as the competition through partial substitution from precision tubes of lower specifications, those producers and suppliers will be able to limit the scope of action of MRW/Hoesch to a considerable extent.

[1] In the interests of business secrecy, the figures given in the original text are replaced in the published version by : well above 25 %.

C. Non-precision tubes excluding line pipes

1. *The relevant product market*

(31) The market for non-precision tubes distinguishes itself by reference to the area of application (as has already been seen above) and the price. In their notification, the parties initially put forward the view that trade and transport tubes could be divided into the following relevant product markets:

— line pipes,

— threaded pipes,

— smooth pipes ('Siederohre'),

— boiler and plant pipes,

— oil-drilling pipes,

— hollow sections.

(32) However, in the course of the proceedings they changed their views to the extent that they now consider all tubes used for the transport of materials (e.g. water, gas, oil, air) as giving rise to a single transport tube market, i.e. all threaded, oil-drilling and line pipes as well as some smooth and some boiler and plant pipes.

(33) The extent to which such pipes can be placed in the same relevant product market as line pipes is considered in detail below.

(34) Leaving aside the market for line pipes, the other product markets affected require no detailed analysis of the precise product market definition since this has no significant effect on the assessment of the proposed concentration. This is valid both for a wider approach (e.g. for hollow sections including construction elements made from other materials) or a narrower approach (e.g. for boiler and plant pipes based on qualitative criteria). Consequently, the precise relevant product market for trade and transport tubes (excluding line pipes), can also be left open.

2. *Geographic reference market*

(35) With the exception of line pipes, the same considerations regarding the definition of the geographic reference market apply for non-precision tubes as for precision tubes. By way of example: in Germany, where the only significant impact of the proposed concentration arises, import percentages for the various non-precision steel tubes vary from 28,5 for boiler and plant pipes to 70 % for hollow sections. Importers are the main steel producers in western and eastern Europe. Consequently, the geographic reference market is almost certainly at least Community-wide (except perhaps for boiler and plant pipes) and for oil-drilling pipes possibly worldwide.

3. *Competition assessment*

(36) On none of the relevant product markets for non-precision tubes (excluding line pipes) does the concentration result in a combined Community market share exceeding 25 %. Major additions to the market share are found only in Germany. Here, the combined market share exceeds 50 % for both oil-drilling pipes and boiler and plant pipes.

(37) Nevertheless, the creation or strengthening of a dominant position on these markets (with the exception of line pipes) can be excluded.

(38) As regards the market for oil-drilling pipes, even if the concentration leads to the fusion of the last two German producers of any importance, the international nature of the oil business removes the scope for uncontrolled action on the German market.

(39) With respect to the market for boiler and plant pipes, in view of the special technical and safety standards in Germany some evidence of a separate German market exists. However, even on that hypothesis there would still be no sufficiently detrimental impact on competition. MRW's market position is improved only in the low end of the market as Hoesch is present only in this segment (Gütestufe 1) and not in the segment for high value boiler and plant pipes. In the low end of the market, import penetration is particularly high. Therefore the improvement in MRW's position in this segment will not increase its scope of action to any appreciable extent in the market as a whole.

D. Steel gas-line pipes

1. *The relevant product market*

(40) The Commission includes in the relevant product market those products which are regarded by the consumer as interchangeable by reason of their characteristics, price and intended use. The Commission also considers whether the scope for suppliers is significantly limited on the market affected through the action of suppliers on neighbouring product markets.

(41) The Commission considers that a relevant product market for steel gas-line pipes (excluding large pipes) exists. The reasons for this are set out below.

1.1. Distinction from other trade and transport tubes

(42) In the first place, line pipes are distinct from the so-called other trade and transport tubes. The latter fulfil partly the same function (e.g. threaded pipes) to the extent that they allow the flow of fluids or gaseous materials. They are, however, clearly distinct from line pipes with regard to their technical specifications (e.g. DIN 2440/2441/2442), their field of application (household use), their users, their method of distribution and their prices.

(43) The undertakings concerned are of the opinion that, because of supply side substitutability and price-interdependence, there exists a single product market for non-precision tubes if all application purposes are taken into account. They claim that non-precision tubes constitute a single product market fulfilling the same basic function, namely the transport of materials (water, gas, oil, hot air for heating, air, solids).

(44) Leaving aside the fact that the information submitted by the parties shows the clear price differences between different trade and transport tubes, the evolution of the graphs submitted by the parties merely reflects the price development of steel tube inputs (as for example here, the price of coils). According to the undertakings these represent 60 % of the total production costs. However, the conditions of competition applying to the markets affected are obviously different (lack of demand side substitutability, different distribution systems). The differences are reflected, *inter alia,* in the completely different import percentages between gas-line pipes on the one hand and the other trade and transport tubes on the other.

(45) The Commission agrees with the parties that large pipes do not belong to the same relevant product market. Compared to other line pipes they are not only different with regard to their size but also with respect to their field of application (very long distance transport, e.g. from Siberia to Germany), their users and their conditions of competition. MRW has already separated out this business area and placed it in a JV (with Usinor Sacilor) called Europipe GmbH.

(46) The parties include water pipes in the same relevant product market. The Commission does not share this view. Water pipes are made according to DIN 2460 and are therefore not permitted for use in carrying gas. In addition, the share of water pipes in the total volume of steel line pipes (excluding large pipes) is only about ... [1]. The share of water pipes in total turnover for steel line pipes is less than ... [1] for MRW and under ... [1] for Hoesch/Fuchs.

1.2. Substitution with pipes made of plastic and other materials

(47) The parties consider that the relevant product market for line pipes includes not only steel pipes but also pipes made from other materials (plastics, cast iron, cement and stone). They justify this by their interchangeable use and, in their view, the very real possibility of substituting plastic pipes for steel ones.

(48) After enquiry with industrial associations, competitors and users of gasline pipes and taking into account the expert opinion presented by the parties, the Commission has come to the conclusion that the underlying reasons for the substitution between steel and plastic gasline pipes is determined principally by the technical possibility of substitution, the (national) safety standards, the existing gas networks of utility companies, and buyer preferences.

(49) The theoretical degree of substitution depends on the particular segment of the gasline pipe market concerned. Those segments correspond to the usual divisions employed by the gas industry, namely:

— low-pressure pipes ($\leq$ 4 bar), which are mainly used for gas distribution at the local level,

— medium-pressure pipes ($>$ 4 bar up to $\leq$ 16 bar), which are mainly used for gas distribution at the regional level,

— high-pressure pipes ($>$ 16 bar), which are also used in regional networks.

— Low-pressure pipes (below 4 bar)

(50) Low-pressure plastic pipes (since these are made from polyethylene they are often denoted as PE pipes) are, being approved for the pressure range up to 4 bar, technically substitutable with steel tubes.

[1] In the interests of business secrecy, the figures given in the original text have been omitted in the published version: in each case, the share is minor.

(51) On this subject the parties' expert has added that:

'The technical/economic planning underlying the construction of a distribution network of line pipes is relatively complex. In the first instance, the following parameters can be mentioned:

— current gas demand and forecast evolution,

— options in the routing of trenches, which have a considerable impact on the costs for digging and surface work,

— pressure range,

— pipe material.

Depending on the technical restrictions for the distribution network to be established or extended, or on the line pipes to be renewed with regard to the required pressure range and choice of pipe material, the objective is to find a low-cost combination of pipe material and line-pipe diameter possessing the necessary flow capacity as well as a sufficient estimated reserve capacity.

With regard to the assessment of the substitution relationships between steel and PE pipes, there exist certain restrictions in very dense distribution networks, in that for technical reasons a large juxtaposition of different materials in het network is to be avoided. The objective is to keep down the number of joints between different materials since these are potentially sensitive to damage. Hence, it is usual that, as part of the pre-planning of the make-up of a distribution network in a region, the choice of material for small extensions or line pipe renewals is already established on the basis of the technical/economic considerations.

Practically no such restrictions exist for the construction of a new distribution network or for line pipes above 1 bar. Thus, the most economical combination of pipe material and diameters for achieving the required flow capacity can be objectively planned and chosen.'

(52) Therefore, even according to the expert opinion submitted by the parties, technical restrictions in the choice of pipe material exist in the dense distribution networks (pressure range up to 1 bar) and it is confirmed that this choice is made in the preplanning phase. According to statistics of the BGW (the Federal Association of the German Gas and Water Industry) for 1990, 98 % of plastic gas pipes are used in that pressure range whereas only 2 % are used in the pressure range between 1 to 4 bar, where according to the expert opinion no such restrictions exist.

(53) Furthermore, the expert opinion also confirms large price differences between steel and plastic pipes with regard to the pipe material and to the pipe-laying costs. Those price differences depend on the pipe diameter (7,6 to 50,6 % for networks up to 1 bar and 14,7 to 61,8 % for networks up to 4 bar). More important is the point that a tube producer can only influence one cost component, namely the simple pipe cost. Should a steel tube producer wish to submit a lower offer to a gas utility, not only does he have to make up the cost disadvantage of the steel pipe, but also the higher pipe-laying costs for a steel pipe. For example, in a network up to 1 bar, he has to make up a cost disadvantage between 13,8 and 66,4 %.

(54) Therefore, with regard to low-pressure pipes, steel and plastic pipes cannot be placed in the same relevant product market. The decision process between steel and PE pipes takes place in the precompetitive stage. In any event, the scope for price increase by a steel tube supplier which had a dominant position would not be limited in a significant way by PE pipe suppliers.

— Medium-pressure pipes (4 to 16 bar)

(55) For medium-pressure pipes there is only limited technical substitution possible between steel and PE pipes. At present, PE pipes can be used on technical grounds only up to a maximum pressure of 10 bar. Possible developments in materials suggest that PE pipes may be developed within a few years for testing purposes up to and including 16 bar.

(56) In assessing the possibilities of substitution in terms of competition, not only do the technical circumstances have to be considered but also the general legal and economic conditions as well as the timing of effective substitution.

(57) It can thus be established that British Gas has limited its regional networks to an operating pressure of 7 bar in order to be able to use PE pipes, and in France and Belgium for example, part of some distribution networks are operated in this pressure range. On the other hand, the maximum operating pressure allowed in Germany for PE pipes is only 4 bar. The use of PE pipes is therefore excluded for the time being for regional distribution networks, since these networks typically have operating pressures in the range 4 to 16 bar.

(58) It cannot be expected that in Germany approval for an extension of the pressure range of PE pipes will be obtained before the end of 1994. Therefore it cannot be supposed that the scope of action of steel suppliers for this pressure range could be significantly limited by PE pipe producers during this period at least. In particular, an isolated change in national standards is not to be expected during the harmonization phase at the European level.

(59) In addition, attention is to be drawn to the substantial price disadvantages of PE pipes in this pressure range, as documented by the parties' expert.

(60) The Commission therefore draws the conclusion that in Germany (See definition of geographic reference market below) PE pipes cannot be included in the same relevant product market.

— High-pressure range (above 16 bar)

(61) At the present time there are no technical possibilities for replacing steel pipes with plastic ones for the high-pressure range. This remains valid for the foreseeable future. Consequently, PE and steel pipes cannot be included in the same relevant product market for this pressure range either.

— Conclusion

(62) Steel and PE gasline pipes cannot be considered to belong to the same relevant product market.

1.3. The market for steel gasline pipes

(63) The above discussion shows that gasline pipes must, for technical reasons, be chosen in the light of the different pressure ranges. Although there exist three different pressure ranges for gas networks, steel gasline pipes are produced (at least in Germany) only according to two different technical standards, i.e. DIN 2470, Part 1 and DIN 2470, Part 2. The first standard covers all steel gasline pipes up to and including 16 bar (since there are no technical differences between steel gasline pipes for the low and middle-pressure range); the second covers the pressure range above 16 bar (high-pressure range).

(64) Furthermore, it has to be taken into account that a large number of customers buy at least either in the low and medium or in the medium and high-pressure ranges. This supports the existence of uniform conditions of competition in the different segments, since, for example, price setting in one segment could not ignore the knock-on effect on the other segments. It can therefore be left open whether a single market exists or whether the market consists of different market segments based on pressure.

(65) The parties have estimated the size of the steel gasline pipes market in Germany at ECU 142 million (annual sales in 1991). The market size estimated by the Commission amounted to ECU 128,1 million, of which ECU 75,1 million related to the pressure range up to 16 bar and ECU 53 million to the pressure range above 16 bar.

1.4. Supply-side substitutability

(66) In the determination of the relevant product market, supply-side substitutability can only be taken into account if manufacturers of products other than the product in question can readily and quickly switch to the production of the latter.

(67) According to the submissions of the parties, supply-side substitutability can be achieved at relatively little cost and with little loss of time.

(68) Nevertheless, the Commission maintains its opinion that other steel tube producers cannot easily and quickly switch their production to gasline pipes, particularly for high-pressure pipes. The essential difference in this assessment lies in the fact that the Commission estimates that:

— more extensive production changes are required,

— the time required is significantly greater, since sufficiently long phases must be allowed for planning, purchasing equipment, construction and testing of the plant, TÜV (Technischer Überwachungsverein — Technical Supervisory Association) approval procedures for the producer and his production, and for the training and testing of his workers.

(69) Ultimately, the question of whether or not sufficient supply side substitutability exists can be left open. In any event, there is a lack of powerful competitors producing only simple trade and transport tubes who, on the basis of assumed supply side substitutability, could quickly enter the market and thus restore common conditions of competition in an assumed combined market for simple trade and transport tubes and gasline pipes. Since all producers of gasline pipes are already today producers of the basic trade and transport tubes and since, as was shown above, clear differences in the conditions of competition nevertheless continue to exist — at least between gasline pipes on the one hand and the other trade and transport tubes on the other — it cannot be accepted that any independent producer of simple tubes of any significance could appreciably change this structural difference,

even if supply side substitutability is substantially easier than is assumed by the Commission. With regard to the ability of current producers of both simple tubes and gasline pipes to use their existing capacity to increase their production of gasline pipes, it should be noted that this is not a problem related to market definition but a question of potential capacity utilization of existing competitors.

1.5. Conclusion

(70) Consequently, the Commission considers that a relevant product market for steel gasline pipes (excluding large pipes) exists. (The product will be referred to hereinafter in abbreviated form as gasline pipes). Whether there exists a single market or whether the market consists of different market segments determined by pressures, can be left open on account of the comparable market position of the undertakings concerned in all segments.

2. *The geographic reference market*

(71) As regards the structural aspects and general competitive framework set out below, the Commission considers that the conditions of competition in Germany are curently different from those in other Member States but that these will change because of the dynamic developments designed to bring about a Community-wide market. However, this change will only be progressive, so that the inference must be that sufficiently homogeneous conditions of competition will not be created throughout the common market in the immediate future. Consequently, it is reasonable at the present time to relate the assessment of the effects of the proposed concentration to the geographic reference market constituted by the territory of Germany.

2.1. The current market situation

— Market share differences as indicators

(72) According to the data collected by the Commission, MRW and Hoesch will become the largest player in the Community, with a market share in the Community of under 40 % in terms of value. The ILVA group follows next with a share of between 25 and 35 % and three companies, British Steel, the Hoogovens Group and Tubos Reunidos, have Community shares of between 5 and 10 %.

(73) However, at present mutual interpenetration of the different national markets remains limited. In all large Member States having their own steel-pipe production, the national suppliers of gasline pipes have the largest market share. In Germany, imports are presently around 10 %. In Italy, the national producer achieves about 90 % and in Spain the corresponding figure is over 70 %. However, in France and the United Kingdom imports are significantly higher.

— Type and characteristics of the product

(74) The market for gasline pipes is chiefly characterized by the technical conditions. These are not yet harmonized in the European Community. It appears that in Germany, France and the United Kingdom the prevailing national standards are used exclusively, whereas in Italy, Spain and the Benelux countries the ISO and the DIN standards can also be used.

(75) Under German law the technical requirements for low and medium-pressure gasline pipes are effectively derived from the law for the energy sector (Energiewirtschaftsgesetz) and for high-pressure gas pipelines from the high-pressure gas pipelines regulation (Verordnung über Gashochdruckleitungen). Neither text establishes specific technical requirements. Both refer to a requirement to satisfy the 'generally recognized technology rules'. According to the legal texts, those requirements are presumed to be satisfied by products satisfying the DVGW (Deutscher Verein des Gas- und Wasserfaches eV — German association of gas and water utilities) rules.

The DVGW working papers (DVGW-Arbeitsblätter) G462, Parts 1 and 2 (low and medium pressure) and G463 (high pressure) lay down the specific rules for gas pipelines. The working papers refer to DIN 2470, Parts 1 and 2. DIN 2470 sets out a large number of detailed standards covering, *inter alia*, the steel used, other material aspects, the production process and the testing procedures. The plastic coating of the line pipes can be undertaken separately by another producer, but in practice this is not often the case in Germany. In any event the manufacturer has to meet the requirements of other DIN standards, such as DIN 30670 for polyethylene coating.

(76) Furthermore, the producer of gasline pipes needs the general technical approval of the TÜV or MPA (Materialprüfungsanstalt — Materials testing authority). Approval covers the production process, equipment for the integrated testing of the products and the qualifications of the employees (e.g. welders). The tests are laid down in the AD (Arbeitsgemeinschaft Druckbehälter — working group for pressurized vessels) notices. All of the major west European steel producers have at least partial TÜV approval for the production of steel gasline pipes.

— Demand-side structure

(77) An important element in the assessment of existing differences in the conditions of competition between the Member States is the demand-side structure. In this respect, the demand side differs markedly between Germany and the other larger Member States with high gas consumption :

— in the United Kingdom, excluding gas pipeline requirements for off-shore gas activities, British Gas has a near monopoly for land-based requirements,

— in France, Gaz de France provides approximately 90 % of the national and local networks,

— in Italy, SNAM owns about 90 % of the national nework and via its subsidiary Italgas about 50 to 60 % of the local supply,

— in Germany, there exists in principle one company for the long-distance network in west Germany (Ruhrgas) and one company in east Germany (VNG). There are more than 30 regional gas distributors and more than 500 local gas utilities. The size of regional distributors and local gas utilities varies appreciably.

— Purchasing decision criteria

(78) Currently, the purchasing policy of German customers is nationally orientated. According to investigations carried out by the Commission, purchasing criteria such as :

— security of supply

— compatibility of the pipes with the existing network

— long-term supply relationship

— technical advice and support and

— the ability to satisfy company specific requirements

have a significant influence on the purchasing decisions of German gas utilities. Therefore the criteria determining purchasing behaviour tend to encourage national buying, in so far as it is now commercially easier for domestic suppliers to satisfy those objective requirements.

2.2. The future market situation — dynamic developments

— Harmonization of technical standards

(79) Harmonization of current European standards for the operation of gasline systems as well as material requirements is now being undertaken by the European Committee for Standardization (CEN). Under the aegis of CEN, 18 countries and representatives of recognized industrial associations are working to achieve a common standard.

(80) Within CEN, work is organized and undertaken by various technical committees (TCs). The TCs themselves may further delegate specific tasks to working groups. The preparation of European standards for gasline pipes is being undertaken by TC 234 and its six working groups. TC 234 was established in 1990 and formal work on the standards commenced in 1992. In particular, TC 234 is responsible for the establishment of functional requirements for the distribution and transport of gas. Amongst other tasks, TC 234 will check if standards produced by other TCs meet these functional requirements and, if necessary, will seek their reformulation. In the case of steel line pipes, TC 234 can draw on the draft standards already prepared by TC 29 of the ECISS (European Committee for Iron and Steel Standardization) namely : 'pr EN 10208/2 : Steel pipes for pipelines for combustible fluids — Technical delivery conditions — Part 2 : Pipes of requirements class B'.

(81) The Commission is preparing a mandate to CEN in the context of Council Directive 89/106/EEC [1] (the 'Construction Products Directive' — (CPD)) for the development of European standards on gasline pipes. Once such a European standard is agreed it will be published in the *Official Journal of the European Communities* as a standard in support of the CPD. Under the procurement rules it is obligatory to use European standards when they exist.

(82) According to CEN, the majority of the European standards of TC 234 will become available in 1996. It is expected that the steel pipe standards prepared by TC 29 will enter into force in 1994. They do not completely coincide with DIN 2470, Part 1 and Part 2, because they do not, for example, extend to the TÜV approval procedure, but they do cover, for example, the important DIN 1626 and 1629 standards.

[1] OJ No L 40, 11. 2. 1989, p. 12.

(83) Until harmonization is completed, the current German DIN standards present a formal market-entry barrier and an economic entry barrier. This is because production and testing must be carried out in accordance with German DIN standards. The importance of this barrier depends mainly on the production volume. The higher the order volumes achieved the less significant are the negative cost effects of adapting the production process to match the German DIN standards.

(84) It can therefore be concluded that, on the one hand, there remain differences in standards between the large Member States and that an immediate change in this position cannot be expected. On the other hand, account must be taken of the fact that most foreign producers have already obtained at least partial TÜV approvals. Furthermore, the approvals lacking and required to cover the full range of requirements of the DIN 2470 standards can be quite easily obtained by suppliers currently producing gasline pipes according to different standards. This is particularly true for the major west European steel producers.

— The Community Directive on public procurement

(85) Procurement patterns of gas utilities currently differ in several respects. In some Member States they are subject to existing national public procurement rules, whereas in others their purchasing procedures are regulated by their own internal rules. In Germany, the gas utilities do not generally publish their invitations to tender because, as was confirmed by nearly all of the utilities questioned by the Commission, they claim to know already those suppliers capable of providing both technically and commercially satisfactory tenders.

(86) Therefore the application of the Community procurement rules (Council Directives 90/531/EEC (1) and 92/13/EEC (2)) which will come into force on 1 January 1993 will help to open up national markets, as they require transparent and non-discriminatory procurement procedures. While it cannot be taken for granted that steel tube suppliers of other Member States will immediately be able to take full advantage of the opportunities thereby created, there will nevertheless be a gradual opening-up of markets.

(87) The most important obstacle to the full effectiveness of the Community procurement rules is that technical standards are not yet harmonized. Thus tender offers can currently be based on national standards. Therefore the full effectiveness of the Community Procurement Directive will be achieved when important parts (e.g. TC 29 in 1994), or the majority of the relevant technical standards (e.g. TC 234 in 1996) have been agreed.

(88) When the Community procurement rules come into force in 1993, their effectiveness will be dependent on the proportion of all national tenders which achieve the minimum purchase volume of ECU 400 000 and which are therefore subject to Community-wide tender. The higher that proportion, the more commercially attractive it will be for foreign suppliers to produce according to DIN standards even though the technical harmonization process has not yet been completed.

In that connection it is estimated that a significant proportion (possibly 50 % or more) of German orders for gasline pipes will achieve the minimum purchase volume under the Directive. Taking into account the long-term commercial and strategic interests in supplying the German market, e.g. because of existing overcapacities, the large absolute size of the German market, the exceptionally high level of demand in the following years due to German reunification, and in particular the certainty that in the foreseeable future even the remaining technical barriers will be removed, it is to be expected that, with the imminent implementation of the Community Public Procurement Directive, foreign suppliers will seek to develop a supply relationship on the German market because they can rely on a further opening-up of the market with regard to the technical standards.

2.3. Conclusion

(89) The Commission therefore takes the view that appreciably different conditions of competition still exist today between Germany and the other Member States because of the above structural elements on the market for gasline pipes. However, the dynamic impulses identified, such as the harmonization of technical standards and the Community Public Procurement Directive, will help to open up the national market. As these changes will come about only over time and will develop progressively rather than all at once, it seems proper to relate the assessment of the effects of the proposed concentration to the German market and to take into account, when appraising the question of market dominance, the effects of the transitional period of the opening-up of the German market.

(1) OJ No L 297, 29. 10. 1990, p. 1.
(2) OJ No L 76, 23. 3. 1992, p. 14.

3. *Market dominance*

(90) In its assessment of market dominance the Commission takes into account not only the current market position of the undertakings concerned and the other structural elements which give rise to the existing conditions of competition but also those structural elements which will in due course change those existing conditions of competition, having regard to the specific circumstances of the individual case under consideration.

3.1. Market shares

(91) Market shares characterize the current market position of an undertaking. High market shares represent an important factor as evidence of a dominant position provided they not only reflect current conditions but are also a reliable indicator of future conditions. If no other structural factors are identifiable which are liable in due course to change the existing conditions of competition, market shares have to be viewed as a reliable indicator of future conditions.

(92) The Commission has obtained the turnover figures of suppliers of gasline pipes in Europe for the last three years, i.e. 1989, 1990 and 1991. On the basis of those figures, market shares in Germany for gasline pipes in 1991 for the two different market segments, i.e. for low and medium pressure on the one hand and for high pressure on the other hand, are as shown below:

(Reference year: 1991)

Supplier	< 16 bar	> 16 bar	Total
MRW	[...] % (*)	[...] % (*)	[...] % (*)
Hoesch/Fuchs	[...] % (*)	[...] % (*)	[...] % (*)
	[...] % (**)	[...] % (**)	[...] % (**)
Flender	< 20 %	—	< 10 %
Klöckner	—	< 10 %	< 5 %
Hoogovens	< 5 %	< 10 %	< 5 %
Arfa	< 5 %	—	< 5 %

(*) In the interests of business secrecy, the figures have been omitted in the published version.

(**) In the interests of business secrecy, the figures given in the original text have been omitted in the published version: in each case, the combined market share was over 60 %.

Neue Maxhütte, British Steel (Mannstaedt), Rautaruukki, Arbed, ILVA, Krieglach and the Turkish company Borusan each have a market share not exceeding 2 % in any market segment or in the market as a whole.

(93) After the concentration, MRW and Hoesch will attain a market share of [...] % (1) which in the high-pressure segment will exceed [...] % (1) and in the low and medium-pressure segment will amount to [. ..] % (1). The total market share of the parties, taking the average over the three years, amounted to [...] % (1). The parties have contested the Commission's calculation of the market shares. Based on their estimates they calculate their total market share for 1991 at [...] % (1) and for the previous two years as being even lower.

(94) Borusan and Rautaruukki recently entered the German market, as did British Steel through its purchase of Mannstaedt from Klöckner. The latter subsequently re-entered the market through the acquisition of a tube-works at Muldenstein in East Germany.

3.2. Other elements of competition

— The product range

(95) The undertakings concerned cover the complete product range of gasline pipes. This applies both to the pressure range and to gas-pipe diameters. Since normally, a single gas utility does not order pipes from the whole product range, the lack of a complete product range does not seem to present a decisive competitive handicap. This has been confirmed by the gas utilities interrogated.

— Distribution

(96) The sale of gasline pipes in Germany takes place predominantly through project-specific calls for tenders. According to the parties, those projects were, in the past, primarily supplied by the tube producers, whereas small repair needs were met by traders. The parties have stated that traders are now increasingly taking part in project-specific calls for tenders.

(97) Within Germany, only German suppliers have been active in direct customer sales. The exception to this is Rautaruukki. British Steel (Mannstaedt) is still selling its gasline pipes through the former owner, Klöckner, and the trader Löwe & Jägers, which belongs to the VIAG-Klöckner group. Usinor has bought the German tube producer Homburger Röhrenwerke. That company does not produce gasline pipes and therefore does not possess a distribution network for such pipes. Where other foreign suppliers have been active in Germany (such as Arbed, Arfa, Borusan, Hoogovens and ILVA), they have operated on the market only through German traders.

(1) In the published version of the Decision, some information has been omitted, pursuant to the provision of Article 17 (2) of Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets.

(98) With regard to distribution the undertakings concerned, as well as other German manufacturers, have therefore a competitive advantage compared to foreign competitors which do not possess their own distribution arrangements for gasline pipes in Germany.

— Vertical integration

(99) The undertakings concerned are totally vertically integrated, from steel production to plastic coating. However, this does not give rise to a significant advantage.

(100) As regards the production of steel inputs, which for gasline pipes means essentially hot-rolled wide strip, there are no notable competitive advantages for the parties as compared with other German competitors. Klöckner is itself a steel producer and Flender has extensive and competitive supply alternatives. The advantage of domestic as opposed to foreign producers does not reside in an internal source of supply, since in the main foreign producers also have their own steel supply. Rather, it lies in the fact that German producers already manufacture steel according to the usual German specifications. On the other hand, the important Community standards prepared by TC 29 governing the production of steel pipes are expected to enter into force in 1994.

(101) German producers enjoy a competitive advantage over their foreign competitors with respect to plastic coating. All German producers (except British Steel (Mannstaedt) and NMH) have the necessary coating facilities. ILVA, Hoogovens/VBF and British Steel also possess such installations.

The parties contest this competitive advantage. They have drawn attention to a number of foreign 'job coaters'. Nevertheless, it has to be pointed out that the coating process also has to meet the DIN standard.

— Transport costs

(102) Differences in transport costs are of no significance for competitors within Germany. For suppliers from countries bordering Germany they should not represent a relevant market entry barrier. Some foreign competitors have declared that these costs curtail their competitiveness on the German market. For all competitors located further afield, e.g. Spain, Greece or Turkey, the transport cost disadvantage for pipes with a diameter above DN 200 has been estimated at 10 % or more. Consequently, the impact of transport costs is not decisive. However, for low order volumes and distant competitors they may represent a specific handicap.

3.3. Potential competition

(103) The Commission considers that the prevailing conditions of competition in the German market for gasline pipes, which have led to the above market position of parties holding a very high combined-market share, will change significantly in due course as a result of potential competition brought about by the dynamic impulses identified.

(104) On the German market for gasline pipes three main kinds of potential competition have to be considered. These are : an extension of the product range of current competitors, the market entry or a significant increase in the existing market participation of west European suppliers, and the market entry of east European competitors.

(105) The probability of an increase in competitive pressure owing to an extension of the product range of current competitors is considered to be low. Only Klöckner has recently invested in the gasline business, following its acquisition of the east German plant Muldenstein. For all other competitors it is considered that the extension of the product range in terms of pipe diameters is expensive and, because of existing overcapacities, improbable for commercial reasons.

(106) The incentives for market entry or for increased market participation of western European suppliers have to be considered significant, because :

— there is a large degree of overcapacity for steel and all kinds of steel tubes throughout Europe,

— there is strong competitive pressure in steel tube markets, in particular for simple trade and transport tubes,

— the German market is the largest European market for gasline pipes and, as a result of German unification, has now a very high level of demand,

— the foundations for an internal market have been created ; the first practical steps will come into force with the Public Procurement Directive on 1 January 1993 and will continue progressively, through the technical harmonization process.

(107) In the specific circumstances of the present case, the period of time deemed appropriate for assessing the impact of potential competition on the parties' scope of action requires special and detailed consideration.

In terms of assessing the timing of potential competition, three dates are important in relation to the existing legal and technical barriers. They are : 1993, with the implementation of the Public Procurement Directive ; 1994, with the expected standardization of steel pipe production ; and 1996, when the majority of steel gasline pipe standards will enter into force.

The dismantling of the barriers will have a significant impact on market entry, since the major Community competitors will have to anticipate the progressive structural changes in the market. Therefore, given the exceptional circumstances of this case, as identified below, it is reasonable to take into account the progressive nature of future developments over a longer period than would be appropriate in other circumstances.

(108) With respect to the existing legal and technical barriers, it has been noted in the preceding analysis that the Public Procurement Directive will enter into force within a few months. It will become fully effective upon the completion of the harmonization of technical standards. Consequently, the attainment of the objective of creating a single European market will take place progressively, even though its realization is still some years away. In the present case, harmonization of the standards for steel gasline pipes will take between two and four years. However, its advent is certain and, as stated above, there are already significant incentives to market entry for the major west European suppliers.

(109) Until now the major west European suppliers such as Britisch Steel, Usinor and ILVA have had little or no share in the German market for gasline pipes and have not established their own distribution system, nor made extensive use of independent traders. However, given the certainty attaching to the new framework for future competition and the imminent implementation of the Public Procurement Directive, these major producers will anticipate the full harmonization of standards and seek to take advantage of opportunities progressively where they arise.

(110) Therefore, given the specific circumstances of this case, the Commission considers that there is strong evidence that there will very probably be a perceptible impact on the German market before full harmonization is completed. The reasons for this view are as follows :

— firstly, the potential competitors, i.e. ILVA, British Steel and Usinor-Sacilor, are amongst the largest steel producers. They have good potential for availing themselves of the immediate, albeit imperfect, opportunities created by the Public Procurement Directive. This is particularly true because they are already active in Germany on neighbouring tube markets, because there seem to be no substantial one-off 'sunk costs' for market entry and because they already hold TÜV approval for part of their product range and can — having regard to the time required and the expected costs — obtain it relatively easily for the other part,

— secondly, there are strong incentives for market entry as indicated above,

— thirdly, notwithstanding the fragmented demand structure in Germany, a significant part of the German market for gasline pipes falls under the Public Procurement Directive,

— lastly, it is reasonable to suppose that the German gas utilities, particularly the larger customers, will seek to involve the major west European suppliers in the competitive process in the German market : on the one hand, given the very high combined market share of Mannesmann/Hoesch, they have a rational incentive to seek alternative sources of supply ; on the other, they have a legal obligation to comply with the requirements of the Public Procurement Directive, and the major west European suppliers will enjoy legal remedies in the event of non-compliance.

(111) The parties have also pointed to the rapid growth in imports from east European producers of semi-finished steel products and simple transport tubes. In particular they have referred to their low labour costs in comparison to Community producers and pointed out that some of these producers hold the necessary TÜV-approval. The east European suppliers alone may not be able to restrict the scope of action of MRW-Hoesch. Nevertheless, they will remain a possible source of competition, in addition to the expected active competition from west European suppliers.

3.4. Conclusions

(112) Given the high combined market share of MRW/Hoesch on the German market for gasline pipes, together with their competitive advantages in relation to the remaining German and foreign competitors, there is strong evidence that the parties concerned may achieve upon completion of the concentration a liberty of action that is not immediately fully controlled by existing competitors.

(113) However, in assessing whether the market position of MRW/Hoesch is such as to significantly impede competition in the common market within the meaning of Article 2 (3) of the Merger Regulation, it has to be borne in mind that the large west European competitors, namely ILVA, British Steel and Usinor Sacilor, are currently not at all — or only minimally — active on the German market. Nevertheless, the incentives and opportunities for market entry are high not only for west European competitors, but also for the east European producers of steel tubes.

(114) The Public Procurement Directive, which comes into effect in only a few months' time, will produce a structural change in the scope for non-German companies' entry into the market. The effectiveness of the Public Procurement Directive will progressively increase and attain full maturity with the completion of the technical harmonization process. It is therefore considered that given the absence of other significant entry barriers, even if a dominant position were created at the outset by the proposed concentration, this would only subsist for a limited period of time because of the high probability of new competition which will quickly erode the position of MRW/Hoesch on the German market for gasline pipes.

VI. OVERALL ASSESSMENT

(115) The Commission has therefore come to the conclusion that the proposed concentration does not give rise to a dominant position on the various product and geographic tube markets as a result of which effective competition would be significantly impeded in a substantial part of the common market,

HAS ADOPTED THIS DECISION:

Article 1

The proposed operation by Mannesmannröhren-Werke AG and Hoesch AG is declared compatible with the common market.

Article 2

This Decision is addressed to:

Mannesmannröhren-Werke AG,
c/o Bruckhaus Westrick Stegemann,
Freiligrathstraße 1,
D-W-4000 Düsseldorf,

for the attention of Herr Rechtsanwalt Moosecker,
Fax No 0049 211 49 79 103;

Hoesch AG,
c/o Bruckhaus Westrick Stegemann,
Freiligrathstraße 1,
D-W-4000 Düsseldorf,

for the attention of Herr Rechtsanwalt Moosecker
Fax No 0049 211 49 79 103.

Done at Brussels, 12 November 1992.

For the Commission

Leon BRITTAN

Vice-President

OPINION

of the Advisory Committee on Concentrations given at the 14th meeting on 20 October 1992 concerning a preliminary draft decision relating to Case IV/M.222 — Mannesmann/Hoesch (1)

(93/C 128/04)

1. The Advisory Committee agrees with the Commission that the proposed concentration Mannesmann/Hoesch is a concentration within the meaning of Article 3 (1) (b) and has Community dimension in accordance with the criteria given in Article 1 of the Merger Regulation.

2. The Advisory Committee shares the conclusion drawn by the Commission that the market raising concern in this case is the market for steel gasline pipes.

3. The Advisory Committee agrees with the Commission that the territory of the Federal Republic of Germany is the relevant geographical market for the assessment of the effects of the proposed concentration.

4. A majority of the Advisory Committee is of the opinion that the Commission's assessment of the dynamic developments in the market is too optimistic and that for the appropriate timescale a dominant position will be created that will significantly impede competition. The proposed concentration is therefore not compatible with the common market.

5. A minority of the Advisory Committee shares the conclusion of the Commission that the proposed concentration can be declared compatible with the common market, because of a series of factors relating to potential competition which is such to alter in the near future the conditions of competition in the market under consideration.

6. The Advisory Committee notes the willingness of the Commission to take account of the other points raised during the discussion on the case.

7. The Advisory Committee recommends the publication of this opinion.

(1) OJ No L 114, 8. 5. 1993.

Commission communication pursuant to Article 115 of the EEC Treaty

(93/C 128/05)

By Decision C(93) 1182 dated 5 May 1993 the Commission has authorized the French Republic not to apply Community treatment to fresh bananas falling within CN code 0803 00 10 and originating in ACP States and in free circulation in the other Member States.

The said Decision is applicable until 30 January 1993.

The text of this decision may be obtained from the Commission, Brussels; fax: (32-2) 295 01 21.

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