

Wilmer Cutler Pickering Hale and Dorr LLP
Wilmer Cutler Pickering Hale and Dorr Antitrust Series

Year 2004

Paper 26

Mind The Gap: Unilateral Effects Analysis
Arrives in EC Merger Control

Sven Volcker*

*WilmerHale

This working paper is hosted by The Berkeley Electronic Press (bepress) and may not be commercially reproduced without the permission of the copyright holder.

<http://law.bepress.com/wilmer/art26>

Copyright ©2004 by the author.

Mind The Gap: Unilateral Effects Analysis Arrives in EC Merger Control

Sven Volcker

Abstract

With the adoption of a new substantive test in the revised Merger Regulation, and the publication of the European Commission's Guidelines on the assessment of horizontal mergers, unilateral effects analysis is poised to become an integral part of merger review in the European Union. Notwithstanding the Commission's insistence on a European terminology ("non-coordinated" rather than "unilateral" effects), the EC thus embraces a concept that has gained substantial traction in the United States since its explicit recognition in the 1992 Horizontal Merger Guidelines as one variant of a "substantial lessening of competition" (SLC) under s.7 of the Clayton Act. This is an interesting development given that only a year ago, the Commission was—at least publicly—still very hesitant to recommend any departure from the traditional dominance test in order to bring the EC merger regime closer to the US SLC test. This article discusses the likely impact of the inclusion of unilateral effects analysis in EC merger control. First, it gives a general introduction to unilateral effects analysis, and illustrates the tentative differences in approach when compared with the traditional dominance test on the basis of a concrete example. Secondly, the article examines merger cases in which the Commission has already undertaken a unilateral-effects type analysis under the guise of the traditional dominance concept. Thirdly, the article describes the inclusion of unilateral effects analysis into the Merger Regulation and the EC Horizontal Merger Guidelines, and briefly recalls the debate preceding these changes. Fourthly, building on the above considerations, the article discusses the possible impact of the introduction of unilateral effects analysis on the conduct and outcome of EC merger control proceedings.

Mind the Gap: Unilateral Effects Analysis Arrives in EC Merger Control

Sven B. Völcker*

With the adoption of a new substantive test in the revised Merger Regulation,¹ and the publication of the European Commission's Guidelines on the assessment of horizontal mergers² (the "EC Horizontal Merger Guidelines"), unilateral effects analysis is poised to become an integral part of merger review in the European Union. Notwithstanding the Commission's insistence on a European terminology ("non-co-ordinated" rather than "unilateral" effects), the EC thus embraces a concept that has gained substantial traction in the United States since its explicit recognition in the 1992 Horizontal Merger Guidelines as one variant of a "substantial lessening of competition" (SLC) under s.7 of the Clayton Act. This is an interesting development given that only a year ago, the Commission was—at least publicly—still very hesitant to recommend any departure from the traditional dominance test in order to bring the EC merger regime closer to the US SLC test.

This article discusses the likely impact of the inclusion of unilateral effects analysis in EC merger control. First, it gives a general introduction to unilateral effects analysis, and illustrates the tentative differences in approach when compared with the traditional dominance test on the basis of a concrete example. Secondly, the article examines merger cases in which the Commission has already undertaken a unilateral effects-type

analysis under the guise of the traditional dominance concept. Thirdly, the article describes the inclusion of unilateral effects analysis into the Merger Regulation and the EC Horizontal Merger Guidelines, and briefly recalls the debate preceding these changes. Fourthly, building on the above considerations, the article discusses the possible impact of the introduction of unilateral effects analysis on the conduct and outcome of EC merger control proceedings.

This article concludes that the Commission will make substantial use of the new "significant impediment to competition" test, and thus by implication of unilateral effects analysis, rather than continuing to focus on the dominance test. However, it is submitted that one should not—at least in the short term—expect that the Commission will routinely base its decision-making on the kind of complex econometric evidence typically presented in unilateral effects cases in the United States. Also, one should not expect a radical change in the level of the Commission's enforcement activity as the result of the new test, even though over time it seems likely that the Commission will indeed encounter the much anticipated "gap case" which it could or would not have challenged on the basis of the dominance test.

Unilateral effects analysis as compared to the dominance test

An introductory discussion of unilateral effects analysis and a comparison with the traditional dominance test is best preceded by a hypothetical example of a merger between companies with differentiated products, the area which has been the principal focus of unilateral effects analysis.³ The following is based on stylised facts recently provided by *Verouden, Baengtsson and Albaek*.⁴ Suppose that potential German purchasers of high quality cars essentially make a choice only between the Audi A6, Mercedes E320, BMW 530i, and Saab 9-5. Even though all these models perform certain basic functions, they are clearly differentiated products, in

³ Unilateral effects analysis can also play an important role where competition is "localised" in other respects, such as mergers of companies with geographically fixed outlets such as supermarkets, service stations or movie theatres. While such markets will often be larger than local due to "chains of substitution," mergers of companies whose outlets are close to each other can be expected to have much more significant effects on prices or output than mergers bringing together outlets that are distant from each other.

⁴ Vicent Verouden, Claes Bengtsson & Svend Albaek, "The Draft Notice on horizontal mergers: a further step towards convergence" (Draft of July 31, 2003), forthcoming in the winter 2003 issue of *The Antitrust Bulletin*.

* Partner Wilmer Cutler Pickering Hale and Dorr LLP, Brussels. Contact: Sven.Voelcker@wilmer.com. The author gratefully acknowledges the assistance of Deirdre Waters, Richard Elliott, Hartmut Schneider, and Markus Hutschneider. The usual disclaimers apply to the end result.

¹ Council Reg.No.139/2004 on the control of concentrations between undertakings: [2004] O.J. L24/1.

² Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings available on the Commission's website at www.europa.eu.int/comm/competition/index_en.html

terms of technical features and the substantial marketing efforts of manufacturers to distinguish their products from the competition. In such a scenario, each manufacturer will set its list price and discount policy to maximise its total revenue without losing too many sales to its three rivals. In doing so, they have to take into account that preferences among car buyers are extremely heterogeneous. For example, some customers will have a strong preference for one particular brand and purchase it unless prices are prohibitive. Another group would consider two brands (say BMW and Saab) as close number one and two choices, but would not consider buying either of the other two at prevailing price levels. Yet another group of buyers would be open to purchasing any of the four models and would make their decision primarily on the basis of price levels.

Now assume that BMW and Saab were to merge, and that under our stylised facts they together account for 35 per cent of high-quality car sales in Germany, while Mercedes accounts for 40 per cent and Audi for 25 per cent. After such a merger, the management of the combined entity would investigate whether it would be profitable to raise prices. Suppose the market research indicates that under pre-merger conditions, a 10 per cent price increase for the BMW 530i would have led to a substantial loss of customers that would otherwise have bought the BMW, and that 50 per cent of them would have chosen the Saab 9-5 over the other two models. Conversely, before the merger, a 10 per cent price increase for the Saab 9-5 model would have led to BMW capturing 40 per cent of those customers that abandon the purchase of a Saab in the face of such a price increase. Under these stipulated conditions, the merger would—if one assumes no change in the strategies of the other two producers or in other market conditions—likely provide an incentive to BMW and/or Saab to increase price somewhat above the pre-merger level, given that the combined entity will recapture a fair proportion of sales lost as a result of the price increase for either brand.

This example allows us to make some initial observations about a number of aspects of unilateral effects analysis that differ to lesser or greater degree from traditional merger analysis under the dominance test:

First, a price increase for the merged entity would be rational regardless of the reactions of other suppliers, Mercedes and Audi, in terms of pricing their existing products. Even if the latter were to leave their pre-merger prices unchanged,⁵ a price increase would still be profitable for the merged entity. Thus, the competition

⁵ Rather than following the merged entity's price increase at least to some extent, which would normally be the more realistic assumption.

authority can predict competitive harm to occur without having to make substantiated predictions about the post-merger pricing behavior of market players other than the merging companies. In particular, the assessment does not depend on the prediction of any tacit collusion between the remaining three players in the market, such as the three manufacturers tacitly agreeing on their discount policies. Hence the term "unilateral effects" or "non-coordinated effects" as distinguished from "co-ordinated effects" or "collective dominance" in traditional EC parlance.

Secondly, the prediction of a post-merger price increase does not decisively depend on the combined entity being the largest player in the market. Indeed, in the stylised example, Mercedes would still have a higher market share than the combined entity. Rather, what is decisive for the level of the expected post-merger price increase is the proportion of customers that would rank the Saab 9-5 and the BMW 530i as their first and second choices, and would thus be less likely to switch to the remaining players in the market in response to a price increase for one of the two brands by the merged entity. In other words, it matters more whether the merged entity's products are "closest substitutes" for a substantial group of customers than whether it has the highest combined share in the relevant market.⁶ In contrast, at least under established notions of what constitutes a dominant position held by a single company, it is difficult to see how the number two firm in the relevant market could be described as holding a "dominant position"; the very term implies that the company in question is the market leader.

Thirdly, where reliable data on customer-switching behaviour is available, market definition tends to become somewhat less important. For example, a showing that a high percentage of BMW customers view the Saab 9-5 as their next-best substitute will make it much harder for the merging parties to argue that the relevant product market should be more widely defined, for example to include luxury or mid-quality cars. Conversely, econometric evidence on the closeness of substitutes may relieve the competition agency of the need to stipulate what may appear to be an artificially narrow market definition to "capture" localised competition such as that between Saab and BMW. Indeed, at least in some cases, econometric data illustrating unilateral effects may serve as an analytical "short cut" in the analysis and may help avoid errors in market definition

⁶ In situations where one finds substantial unilateral effects in mergers that do not create the market leader under the stipulated market definition, it may be tempting to re-define the market such as to better reflect the preferences of customer groups that rank the merging parties most highly. See below.

as a result of preconceived notions of substitutability that may be more influenced by personal experience or intuition rather than based on a careful analysis of the likely reactions of marginal customers.

Fourthly, the focus on the "closeness" of products under unilateral effects-type analysis will normally require more than the traditional analysis of expected market entry or expansion of rivals under the dominance test. Assume that in the present example the Saab and BMW models are considered close substitutes by a significant group of customers for the reason that they project a more youthful and dynamic image than their competitors. In such a scenario, a post-merger price increase is sustainable only for as long as Mercedes and Audi do not offer models that project a similar image. However, especially in markets in which product differentiation is primarily a function of branding and minor product modifications rather than a complete re-design involving substantial sunk costs, it is often fairly easy for competing suppliers to reposition their products to become closer substitutes to the products of the merged entity and thus to target the segment of demand that is most likely to become the victim of post-merger price increases. Thus, in the present scenario, Audi and Mercedes could quite possibly defeat the merged entity's price increase by altering their advertising strategy for their existing models, or by modifying those models by including certain extra features that would appeal to buyers looking for a younger and more dynamic image.

Fifthly, the assessment of efficiencies within unilateral effects analysis would appear to have a different character than under the traditional dominance test. Under the dominance test, efficiencies arguments are not essential to achieve clearance unless the merging parties' market shares exceed certain thresholds that typically indicate the possibility of a dominant position (say 40 per cent). Where the parties do exceed such market-share thresholds, they may be hesitant to make a strong efficiencies case for fear that any substantiated efficiencies may be viewed as "entrenching" any dominant position created by the transaction. Despite the Commission's protestations to the contrary, this is not a wholly unreasonable concern given that even the Commission's draft Horizontal Merger Guidelines of 2002 (hereinafter the "2002 Draft Merger Guidelines") indicated that production and distribution efficiencies could be important indicators of a dominant position.⁷ Conversely, unilateral effects analysis, with its focus on post-merger pricing incentives for individual brands even in cases

where the parties' combined market shares do not appear particularly high, would appear to make efficiencies arguments both more necessary and less risky: more necessary to the extent that the threshold for intervention under unilateral effects analysis is potentially lower; less risky given that unilateral effects analysis—at least its US variant—is focused on whether the merged entity will have an incentive to raise its prices and is largely unconcerned with rivals' continuing ability to compete.⁸

It is thus evident that there are some identifiable differences in approach between a unilateral effects analysis and one based on the traditional dominance test, without the two approaches being mutually exclusive or the choice of approach necessarily being outcome-determinative.

Unilateral effects-type analysis in the Commission's practice under the guise of the dominance test

Under the heading "merging firms are close competitors," the new EC Horizontal Merger Guidelines cite a number of past cases for the proposition that "the higher the degree of substitutability between the merging firm's products, the more likely it is that the merging firms will raise prices significantly"⁹ and other cases in which "rivalry between the parties has been an important source of competition on the market" and this was

and 22. The Draft Notice is available at www.europa.eu.int/comm/competition/mergers/review/.

⁸ As is evidenced by para.36 (listing situations in which the combined entity may be able to hinder expansion by competitors) of the EC Horizontal Merger Guidelines (cited above, n.2), the Commission assumes that rivals will normally want to undercut the combined entity, which explains why it views an analysis of the relative "commercial and financial" strengths of the combined entity's competitors as important. This approach is strongly supported by the Community Courts. See, e.g. Joined Cases C-68/94 & 30/95 *France v Commission* ("Kali +Salz") [1998] E.C.R. I-1375; [1998] 4 C.M.L.R. 829, at 1525-1526: "[T]o assess with a sufficient degree of probability the effect which a concentration might have on competition in a relevant market, it is essential to rely on a rigorous analysis of the competitors' weight." This contrasts to some extent with the analysis in the US, where the prevailing assumption seems to be that higher concentration will also induce the remaining firms, except perhaps for a few small firms on the fringe, to collude and thus to raise their prices. As a result, there is little reason to examine their "strength" as a competitive counterweight to the combined entity: see Thomas Kauper, "Merger Control in the United States and the European Union: Some Observations" (2000) 74 *St John's L. Rev.* 305 at pp.335-336.

⁹ EC Horizontal Merger Guidelines, cited above, n.2, para.28.

⁷ Draft Commission Notice on the appraisal of horizontal mergers under the Council Regulation on the control of concentrations between undertakings (December 11, 2002), paras 21

a “central factor in the analysis”.¹⁰ Further cases are cited for the proposition that “the merging firms’ incentive to raise prices is more likely to be constrained when rival firms produce close substitutes to the products of the merging firms than when they offer less close substitutes.”¹¹ It thus appears that, on the one hand, the Commission has taken into account the “closeness” of the merging parties’ products or the elimination of “rivalry between them” as an aggravating factor in the analysis of whether the proposed transaction would lead to the creation or strengthening of a dominant position. On the other hand, it has accepted the fact that the parties did not offer close substitutes as a defense in *prima facie* cases of dominance due to high combined market shares. The respective cases are discussed in turn below.

Unilateral effects as an aggravating circumstance in the dominance analysis

While the number of cases cited in the EC Horizontal Merger Guidelines¹² suggests that the Commission already has extensive experience in analysing unilateral effects, a survey of those cases and others in the Commission’s practice reveals a slightly more sobering picture.

As regards those cases in which the Commission found that mergers lead to the “elimination of rivalry” between the merging firms, or used similar language, it appears that this is mostly a shorthand for saying that post merger the combined entity would be the clear market leader that no longer faces *any* significant competitor. For example, in the first decision in which unilateral effects-type analysis played an explicit role, *Du Pont/ICI*¹³ in 1992, the merger would have resulted in a combined share of over 40 per cent in the EC nylon carpet fibre market, more than twice that of the next competitor. Aside from the high combined market share, the Commission considered the leading positions of both Du Pont and ICI in R&D, the similarities of their marketing and sales strategies, and their degree of vertical integration. While the Commission considered that ICI was Du Pont’s “closest competitor overall”, it based this finding on the fact that both companies “sell a wide variety of differentiated products”, without

analysing whether the parties’ products could be considered closest substitutes.¹⁴ In *KNP/Bührmann-Tetterode and VRG*¹⁵ the merger would have led to the merging parties controlling approximately two-thirds of the distribution and servicing market of printing presses in terms of market value. The Commission found that the printing presses distributed by the merging parties were “the basic alternatives” from the viewpoint of customers and essentially the only competitive constraint on either party. The merger would eliminate this constraint.¹⁶ Similar cases in which the Commission unsurprisingly found that the mergers eliminated the main source of competition for one of the parties include *Promatech/Sulzer*,¹⁷ (combined market share of 65 to 75 per cent on the market for rapier machines, a type of weaving machine) and *SCA/Metsä Tissue*¹⁸ (combined market shares of 60 to 90 per cent for branded toilet tissue and kitchen towels).

The two cases the EC Horizontal Merger Guidelines cite specifically for the proposition that the degree of substitutability between the merging firms’ products determines the likelihood of post-merger price increases equally do not reveal an in-depth analysis in this respect. The *Volvo/Scania* merger¹⁹ would have resulted in combined market shares ranging from approximately 60 per cent to 90 per cent in a number of Scandinavian markets for heavy trucks. The Commission found that Volvo and Scania trucks were each others “closest substitutes” on the sole basis that market share gains by one producer appeared to correspond with losses by the other over a long period of time.²⁰ In *Barilla/BPL/Kamps*,²¹ the combined market share of the parties post-merger in the market for bread substitutes would range from 60 to 80 per cent and would range from 80 to 90 per cent in the narrower crisp bread segment. One of the parties, Barilla, had the brand with by far the largest share of the market (the Wasa brand). The Commission found that Kamps’ brand was the closest substitute to Wasa on the basis of a survey of customers and competitors which indicated that consumers were significantly more likely to switch to Kamps’ brand than any other in the event of

14 *Du Pont/ICI*, para.[34].

15 Case IV/M.291, May 4, 1993.

16 *KNP/Bührmann-Tetterode and VRG*, paras [21]-[25].

17 Case COMP/M.2698, July 24, 2002.

18 Case COMP/M.2907, January 31, 2001.

19 Case COMP/M.1672, March 15, 2000.

20 *Volvo/Scania*, paras [82] and [107]. It seems highly questionable whether such observations constitute probative evidence, given that the charts reproduced in the decision itself in fact show both Volvo’s and Scania’s shares increasing or declining in unison for certain periods in certain countries. In any event, an analysis based on market share fluctuations would appear to be a rather weak substitute for the ranking of brands by customer groups and the calculation of diversion ratios.

21 Case COMP/M.2817, June 25, 2002.

10 *ibid.*

11 *ibid.*

12 EC Horizontal Merger Guidelines, see n.2 above, para.28 and nn.34 and 35.

13 Case IV/M.214, September 30, 1992.

a price increase for Wasa.²² On this basis, the Commission found that the merger would remove the closest substitute to the leading brand and would therefore raise competition concerns regardless of whether the relevant market should be defined as crisp breads or more broadly as bread substitutes.²³

The best examples for the use of unilateral effects analysis are a number of cases in which the Commission analysed bidding markets. The most prominent and recent cases both concern the neighbouring markets for clinical patient monitors, respirators and anaesthesia machines, *Siemens/Drägerwerk/JV* and *GE/Instrumentarium*.

In *Siemens/Drägerwerk/JV*,²⁴ the Commission found that the combined entity would have high combined market shares for both respirators and anaesthesia equipment in several EU countries (in most cases above 50 per cent). In its finding that the transaction created a dominant position in these markets, the Commission relied not only on these high market shares, but also on the fact that customers generally viewed the parties' products as "closest" or at least as "close" substitutes. The Commission based this finding on (i) the responses by customers and competitors in the context of the Commission's own market investigation; (ii) internal documents of the parties; and (iii) an analysis of the parties' bidding data.²⁵ While much of the information as regards (ii) and (iii) is redacted as confidential in the public version of the decision, the Commission's discussion of the responses by customers and competitors is interesting in that customers seemed to rank the products of Siemens and Dräger as the best alternatives for each other, yet seemed to say that they would only switch between brands in the face of very substantial price increases (10 to 30 per cent or even higher), whereas competitors' views as to the closeness of the parties' products were so diverse that they revealed "no clear pattern".²⁶ The Commission also briefly discussed competitors' ability to reposition their products. For respirators, it found that the next largest competitor, Tyco, was too weak to be a realistic repositioning candidate, in particular because of its limited distribution and service network.²⁷ For anaesthesia machines, however, the Commission did not discuss the capability

of the second-largest competitor, Datex-Ohmeda, to reposition its products, but merely noted that fringe players would be unable to do so on a par with the merging parties and Datex-Ohmeda.²⁸

The *GE/Instrumentarium* merger²⁹ would have led to a combined market share for perioperative patient monitors of approximately 65 to 70 per cent according to the Commission's findings.³⁰ The parties had argued that this high market share was not indicative of a dominant position, *inter alia*, because GE was not a major player in the market and not a close competitor to Instrumentarium. The Commission disagreed. It looked at the range of products offered by GE and its reputation with hospitals. On average, hospitals ranked all four suppliers (GE, Instrumentarium, Philips and Siemens) at the same high level.³¹ The Commission then conducted a series of statistical analyses based on the bidding data supplied by all four competitors. According to the decision, this data showed that, at EEA level, the merging parties were the only significant competitors in one out of every three tenders. In those tenders where the parties faced other major players, they exercised a competitive constraint on those players.³² The Commission also reviewed a win/loss analysis provided by the parties and found that it demonstrated that GE was by far the most frequent runner-up to Instrumentarium in three countries and runner-up in 30 to 40 per cent of cases at EEA level.³³ In addition, the Commission looked at the pricing of bids submitted by the parties when they faced each other and when they faced other competitors. This data showed that the discounts offered by either party increased significantly when the other party also bid, at least in France.³⁴ Last, the Commission relied on an econometric study provided by Philips, a competitor of GE and Instrumentarium, that concluded that Philips had to offer higher discounts where both GE and Instrumentarium were present than in cases where only one of them submitted a bid.³⁵ The Commission found that combined with the parties' high market shares, this economic data reinforced the presumption that the parties could raise price post-merger and thus supported the Commission's dominance finding.

22 *Barilla/BPS/Kamps*, para.[34].

23 *ibid.*, para.[38].

24 Case COMP/M. 2861, April 30, 2003.

25 *Siemens/Drägerwerk/JV*, paras [88]–[106] (respirators) and [123]–[146] (anaesthesia equipment).

26 *ibid.*, paras [88]–[90] (respirators) and [123]–[126] (anaesthesia equipment).

27 *ibid.*, para.[105].

28 *ibid.*, para.[144].

29 Case COMP/M.3083, September 2, 2003.

30 *GE/Instrumentarium*, para.[110].

31 *ibid.*, para.[129].

32 *ibid.*, paras [131]–[134].

33 *ibid.*, paras [142]–[147].

34 *ibid.*, paras [166]–[175].

35 *ibid.*, paras [167]–[183].

Absence of unilateral effects as a factor militating against a dominance finding

Conversely, in a number of cases, the Commission accepted that the absence of a close competitive relationship between the merging parties can be an important consideration in clearing a merger despite relatively high market shares.

Notably, in the *Volvo/Renault* merger,³⁶ entered into following the Commission's prohibition of the proposed *Volvo/Scania* merger, the Commission again considered the market for heavy trucks at national level. In France, the merger would have led to a combined market share of 49 per cent, which is above the traditional *prima facie* dominance threshold. However, the Commission took into account a pricing study concerning the effect of a Volvo price increase that was not matched by competitors in France. This data suggested that customers viewed Scania and DAF as better substitutes for Volvo than Renault. Moreover, a competitor's response to the market investigation stated that customers' product perception of Volvo and Renault was completely different (with Volvo at the high end of the scale and Renault at the lower end). This lack of a close competitive relationship between the merging parties led the Commission to find that the merger did not raise competition concerns in the French market.³⁷

In *Philips/Agilent Health Care Solutions*,³⁸ the merger would have resulted in a combined market share for high-end cardiac ultrasound machines of about 40 per cent at European level and would leave only three to four major suppliers on the market. Nonetheless, the Commission found that the merger would not lead to the creation of a dominant position, *inter alia*, because the machines manufactured by Philips and Agilent's medical businesses were not the closest substitutes. In this respect, an economic analysis of "win/loss" data from tenders over a three year period showed that third parties were the strongest challengers to Philips and that Agilent's machines were generally ranked third. On this basis, Philips could not be expected to raise prices post-merger without facing competitive constraints by the other first-tier suppliers.³⁹

In *Philips/Marconi Medical Systems*,⁴⁰ the merger would have resulted in a market share exceeding 35 to 40 per cent in a number of national markets for various medical scanning equipment (CT scanners, MRI scanners and NM scanners). The parties submitted a study based on win/loss data from prior tenders, showing that

Marconi Medical Systems was not the closest competitor to Philips—other competitors (Siemens and GE) tended to place second when Philips won tenders or tended to win those tenders that Philips lost. This study was accepted by the Commission and was a factor in its conclusion that the merger would not lead to competition concerns.⁴¹

Finally, in *Pfizer/Pharmacia*,⁴² the addition of Pharmacia's market share in calcium antagonist plain drugs was held not to result in a strengthening of Pfizer's already dominant position because third parties' products were viewed by doctors as the most effective substitutes to Pfizer's product and Pharmacia's product was declining in market share. Therefore, the merger would not result in the loss of a closest competitor from the market.⁴³

Conclusions on the Commission's case law

The cases discussed above provide a number of insights into the Commission's thinking in the area of unilateral effects:

First, to the extent that the Commission has relied on unilateral effects analysis as an aggravating circumstance in the context of its dominance analysis, it has done so only in cases in which market shares were at a level that would strongly indicate single dominance in any event. In all of the cases cited above the combined entity was the market leader. Thus, the Commission has so far used unilateral effects analysis only as an additional consideration to bolster its dominance findings when it seemed relatively safe to do so. Conversely, in "grey zone" cases with combined market shares of around 40 per cent, parties appeared to have enjoyed some degree of success in arguing that the transaction would not create a dominant position due to the absence of unilateral effects.

Secondly, the Commission appears to be most at home with unilateral effects analysis in bidding markets. Interestingly, the Commission appears to not yet have employed unilateral effects analysis of any degree of sophistication in a branded goods merger case, save for *Barilla/Kamps* where the market shares were at a level to make a detailed analysis superfluous. Since branded consumer goods are the archetypes of differentiated products, extensive scanner data for econometric analysis are typically available, and such data have been the focus of unilateral effects analysis in the US, it seems reasonable to expect that the Commission will try to use

36 Case COMP/M.1980, September 1, 2000.

37 *Volvo/Renault VI*, paras [33]–[35].

38 Case COMP/M.2256, March 2, 2001.

39 *Philips/Agilent Health Care*, paras [33]–[35].

40 Case COMP/M.2537, October 17, 2001.

41 *Philips/Marconi Medical Systems*, paras [31]–[34].

42 Case COMP/M.2922, February 27, 2003.

43 *Pfizer/Pharmacia*, para.[77].

future branded consumer goods mergers in order to refine its unilateral effects analysis.

Thirdly, where the Commission has conducted a unilateral effects analysis, it does not seem to have devoted much attention to dynamic factors, in particular competitors' ability to reposition their products. As explained above, in *Siemens/Drägerwerk/JV*, the Commission appears to have ignored the possibility that the combined entity's principal competitor in the market for anesthesia machines could have repositioned, focusing only on fringe players' ability to reposition. Other Commission decisions evaluating bidding markets, including *GE/Instrumentarium*, do not contain any discussion of repositioning. While it does not seem implausible that repositioning is more difficult in markets where purchasing decisions are primarily made on the basis of technical characteristics which are not easily altered, one would nevertheless expect the Commission to include more dynamic elements in its analysis. It is thus heartening that in *Barilla/BPL/Kamps* the Commission did consider the possibility that a competing brand could be positioned in sufficient proximity to the merged entity's "crisp bread" brands to be considered a close substitute. In that case the Commission found that the competitor in question would have to set up a new production line, thus reducing its ability to replace the loss of the closest substitute to the leading Wasa brand.⁴⁴

The inclusion of unilateral effects analysis into the Merger Regulation and the EC Horizontal Merger Guidelines

Notwithstanding the Commission's cautious experiments with unilateral effects analysis under the guise of the dominance test, it was not inevitable that it would one day explicitly embrace the concept. This section briefly recalls the debate concerning the possibility of replacing the dominance test with the SLC test, and thereby implicitly also unilateral effects analysis. It then outlines the evaluation of the unilateral effects concept in the Commission's new Horizontal Merger Guidelines.

The debate concerning the change from the dominance to the SLC test

The 2001 Green Paper kicking off the Commission's review of the Merger Regulation contains its first public

⁴⁴ *Barilla/BPL/Kamps*, see n.21 above, para.[36].

reflection of the merits of a change of the dominance test. While not formally taking a position on the issue, the Commission expressed clear reservations about such a change. It pointed out that any greater degree of international "convergence" that would be achieved with SLC jurisdictions such as US, Canada, and Australia (the UK and Ireland had not yet adopted the SLC test at that point) would have to be counterbalanced against the rift that might open with those Member States and Accession countries that have just adopted the dominance test. The Commission notes the similarities of the dominance and SLC tests, in particular given the evolution of the dominance test under the Merger Regulation from a "blunt and relatively imprecise market share test" to incorporate both the notion of collective dominance and the use of econometric tools to measure market power.⁴⁵ Of particular interest are the Commission's statements regarding the perceived "enforcement gap" under the dominance test—an issue that has since taken on considerable and perhaps undue notoriety. While the Commission recognises that there could be situations in which horizontal mergers create competitive harm that would nevertheless not be covered by the dominance test—namely the merger between the second and third largest players in the market where these firms' products are the closest substitutes—it notes that "while interesting as a hypothetical discussion, the Commission has so far not encountered a situation of this kind".⁴⁶

The feedback received on the Green Paper by interested third parties equally did not suggest widespread enthusiasm for a switch to the SLC test, and implicitly to unilateral effects analysis. According to the Commission's summary, a number of respondents expressed concern that the much more flexible SLC test could become "a dangerous weapon in the hands of the Commission, allowing it to become unacceptably interventionist".⁴⁷ However, it was also noted that an SLC test would avoid the risk of "cross-contamination", that is to say, the risk that an overly flexible and expansive interpretation of the dominance test under the Merger Regulation could lead to a similarly wide interpretation of the dominance test under Art.82 EC, unduly curtailing many companies' ability to engage in a number of

⁴⁵ Commission, Green Paper on the Review of Council Reg.4064/89, COM(2001) 745/6 final (hereinafter: "Green Paper"), para.163.

⁴⁶ Green Paper, para.166.

⁴⁷ Commission, Green Paper on the Review of Council Reg.4064/89—Summary of the Replies Received, (hereinafter: "Comments on the Green Paper"), para.102. The Comments on the Green Paper are available at http://europa.eu.int/comm/competition/mergers/review/comments/summary_publication.pdf.

common business practices.⁴⁸ Perhaps not surprisingly given that most of the respondents represented industry interests, relatively few seemed to have expressed concerns that there was any “enforcement gap” under the Merger Regulation that would have to be filled by an explicit recognition of unilateral effects analysis.⁴⁹

In light of these developments, one would have expected the Commission not to recommend a change of the dominance test and move to an SLC-type test. And yet, in its proposal to the Council in December 2002, the Commission moved substantially in that direction. The Commission proposed to keep the dominance test, but to insert in Art.2(2) of the Merger Regulation a merger-specific definition of dominance:

“For the purpose of this Regulation, one or more undertakings shall be deemed to be in a dominant position if, with or without co-ordinating, they hold the economic power to influence appreciably and sustainably the parameters of competition, in particular, prices, production, quality of output, distribution or innovation, or appreciably to foreclose competition.”⁵⁰

While it may not be readily apparent from the proposed text itself that it was meant to introduce unilateral effects analysis into the Merger Regulation, the Commission’s Explanatory Memorandum as well as its concurrently published Draft Guidelines provide greater clarity in this respect.

In its Explanatory Memorandum, the Commission linked the proposed change to the perceived “enforcement gap” of the dominance test, *i.e.* the unilateral effects scenario in which the firms would have the power to raise prices post-merger without co-ordination with other players and without holding the largest market share. The Commission stressed the need for greater legal certainty in this respect, notwithstanding its suggestion that the notion of collective dominance may actually cover this scenario⁵¹ and its earlier assertion in the Green Paper that this was largely an academic debate anyway.

The Draft Guidelines were more explicit as regards the recognition of unilateral effects, even though they do not use the term. They identified three main types of competitive harm: (i) the creation of a “paramount market position”; (ii) a “non-collusive oligopoly” through the elimination of competitive constraints that

the merging parties previously exerted on each other; and (iii) an increased risk of co-ordination. While the—subsequently heavily criticised—section on the “paramount market position” very much smacked of traditional dominance analysis, the section on non-collusive oligopolies was clearly informed by the unilateral effects analysis of the US Horizontal Merger Guidelines. While many had taken issue with the “text-book approach” of the Draft Guidelines in terms of distinguishing between “markets where firms compete primarily in output/capacity” and “markets where firms compete primarily on prices”,⁵² the discussion of unilateral effects in markets with differentiated products⁵³ was relatively uncontroversial. The Draft Guidelines stated that the Commission would first focus on the degree of substitution between the merging firms’ products, secondly on the degree of product differentiation between the merging firms and their competitors’ products, and thirdly on competitors’ ability to reposition their products or to extend their product portfolio.⁵⁴ With the exception of the lack of any indication of market-share thresholds, the Draft Guidelines were indeed very similar to the US Horizontal Merger Guidelines.

Amendment of the Merger Regulation and adoption of the Guidelines in their final form

The Commission’s proposal for changing the substantive test of the Merger Regulation, as well as its proposed distinction between a “paramount market position” and “non-collusive oligopolies” have not survived the negotiations in the Council of Ministers and the Commission’s consultation process, respectively. However, unilateral effects analysis has emerged all the stronger from the process.

As regards the substantive test under the Merger Regulation, the Council was not persuaded of the wisdom of re-defining the dominance test as proposed by the Commission. It is widely known that at least the German delegation resisted any change to the traditional dominance test.⁵⁵ But it also appears that a number of other delegations, including those favouring

48 Comments on the Green Paper, para.96.

49 *ibid.*, para.94.

50 Commission Proposal for a Council Regulation on the control of concentrations between undertakings, [2003] O.J. C20/4.

51 Commission Proposal for a Council Regulation on the control of concentrations between undertakings— Explanatory Memorandum [2003] O.J. C20/4, para.54 and n.17.

52 See Draft Guidelines at paras 30–39, and the critique by Kolasky & Elliott, “The European Commission Notice on the Appraisal of Horizontal Mergers” (2003) *Antitrust* 64 at pp.66–67.

53 Draft Guidelines, cited above at n.7, paras 34–37.

54 Draft Guidelines, cited above at n.7, paras 34–37.

55 See, e.g. Böge & Müller, “From the Market Dominance Test to the SLC Test: Are There Any Reasons for a Change?” [2002] E.C.L.R. 495 (President and Head of Unit of the Federal Cartel Office arguing that there is no reason for a switch to the SLC test).

a switch to the SLC test, believed that the cure proposed by the Commission was worse than the perceived disease. Ultimately, the Council agreed on a compromise proposal that provides for a curious form of co-habitation of a variant of the SLC test and the dominance test. According to the revised Art.2(3) of the Merger Regulation:

“A concentration which would significantly impede effective competition, . . . in particular as a result of the creation or strengthening of a dominant position, shall be declared incompatible with the common market.”

The Council thus inverted the traditional test under the Merger Regulation, turning the (in practice much neglected) second limb of Art.2(3) (“as a result of which effective competition would be significantly impeded”) into the principal test, and listing the creation or strengthening of a dominant position as only one example, albeit the principal example, of such a significant impediment. The Council also agreed on recitals that reflect the fact that the change was intended to address precisely those oligopoly situations in which unilateral effects can arise but that may not be covered by the dominance test.⁵⁶

The final version of the Commission’s Guidelines also differs substantially from the Draft Guidelines. As mentioned above, the Guidelines abandon the idea of a separate category of “paramount market position”. Instead, the Guidelines now define two principal groups of competitive harm—“non-co-ordinated” (unilateral) effects, and co-ordinated effects.⁵⁷

The Guidelines’ discussion of “non-co-ordinated” effects begins with an introduction that distinguishes non-co-ordinated from co-ordinated effects. It then notes that non-co-ordinated effects “typically” arise where the combined entity has an “appreciably larger market share than the next competitor post-merger,” but points out that a significant impediment to effective

competition can also result from a reduction of the competitive constraints that the merging parties previously exerted on each other,⁵⁸ which could include a situation in which the combined entity does not have the largest share of the relevant market.

The Guidelines state that “[a] number of factors, which taken separately are not necessarily decisive, may influence whether significant non-co-ordinated effects are likely to result from a merger.”⁵⁹ A non-exhaustive list of such factors is set out in the Guidelines: (i) large market shares held by the merging firms; (ii) merging firms are close competitors; (iii) customers have limited possibilities of switching supplier; (iv) competitors are unlikely to increase supply if prices increase; (v) the merged entity is able to hinder expansion by competitors; and (vi) the merger eliminates an important competitive force.

The discussion of factors (ii) and (iv) is of greatest interest for the discussion of unilateral effects; both sections are even more closely related to the pertinent sections of the 1992 US Horizontal Merger Guidelines than was the case for the Draft Guidelines.⁶⁰ The final version of the Guidelines adds some additional references to the Commission’s existing practice, makes reference to the fact that the parties’ pre-merger margins are relevant for an examination of the likelihood of price increases,⁶¹ and lists some of the analytical tools for measuring the degree of substitutability.⁶²

In conclusion, both the change of the Merger Regulation’s substantive test and the Commission’s Guidelines now provide a clear legal basis and basic framework for a unilateral effects analysis. However, in common with the US Horizontal Merger Guidelines, neither the Regulation nor the Guidelines give any detailed guidance as to how such analysis should be conducted in practice. As a result, it is up to the Commission to give practical meaning to the concept through its future practice.

58 Guidelines, para.25.

59 Guidelines, para.26.

60 The discussion of the other factors in the Guidelines is more informed by traditional dominance analysis, with factor (v) seemingly being more relevant for vertical mergers. Factor (vi) is a somewhat curious amalgam of the notion that the elimination of a “maverick” firm can be particularly detrimental to competition (a notion that is typically associated with co-ordinated effects cases), and the specific issues arising from mergers in innovation markets such as pharmaceutical markets.

61 Guidelines, para.28 (“high pre-merger margins may also make significant price increases more likely”).

62 Guidelines, para.29 (“[T]he degree of substitutability may be evaluated through customer preference surveys, analysis of purchasing patterns, estimation of the cross-price elasticities of the products involved, or diversion ratios”).

56 See the amended Recital 25 (formerly Recital 21): “Many oligopolistic markets exhibit a healthy degree of competition. However, under certain circumstances, concentrations involving the elimination of important competitive constraints that the merging parties had exerted on each other, as well as a reduction of competitive pressure on the remaining competitors, may, even in the absence of a likelihood of co-ordination between the members of the oligopoly, result in a significant impediment to effective competition.”

57 Commission Notice, Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, cited above at n.2 (hereinafter: “Guidelines”), para.22.

Possible effects of the inclusion of unilateral effects analysis on the Commission's merger practice

The following discussion is an attempt to extrapolate from the relatively general statements in the Guidelines and the Commission's past practice in order to identify some of the issues that are likely to arise from the changes to the legislative framework, and where appropriate to make some predictions as to how these issues will likely be resolved in practice.

What role will unilateral effects analysis play in practice given the continuing presence of the dominance test?

Given the continued presence of the dominance test in the new Merger Regulation, a threshold question is whether the change in the substantive test and the explicit recognition of unilateral effects analysis in the Merger Guidelines will have any practical effect at all. It is not inconceivable that the Commission could continue to base its enforcement practice primarily on the dominance test, and—as it has in the past—use unilateral effects analysis as more of a auxiliary consideration to shore up its single-dominance assessment, or as a “safety net” in cases where it is uncertain whether the conditions for collective dominance are met. Indeed, the Guidelines themselves state that:

“it is expected that most cases of incompatibility of a concentration with the common market will continue to be based on a finding of dominance. That concept therefore provides an important indication as to the standard of competitive harm that is applicable when determining whether a concentration is likely to impede effective competition to a significant degree, and hence, as to the likelihood of intervention”.⁶³

Several factors nevertheless suggest that the Commission will in practice be tempted to rely on unilateral effects analysis to a more significant extent than these comments suggest.

First, as explained above, the debate on the reform of the substantive test of the Merger Regulation has focused heavily on the perceived shortcomings of the dominance standard in preventing situations that could lead to post-merger price increases even where the combined entity does not have the largest market share. It would be odd if the Commission refused to test the limits of the new “significant impediment to effective

competition” standard in the one area in which it was clearly meant to make a difference, in particular given that the Council has made it clear that non-collusive oligopolies are the *only* area in which the introduction of the new test was to enlarge the Commission's powers.⁶⁴

Secondly, the Commission's traditional approach to decision making is likely to lead to an exploration of the limits of the “significant impediment to effective competition” test even where the dominance standard is most likely met as well. The Commission has a known tendency to explore and pursue as many different alternative theories of competitive harm as possible in the course of an in-depth investigation, at least up to the stage of the Statement of Objections and sometimes into the final decision itself. Such an approach is typically motivated by fear that not all theories of competitive harm may survive internal or—as the case may be—judicial scrutiny. Thus, if the Commission is unsure whether it will succeed in making a compelling dominance case, it will conclude that, at the very least, the merger creates a significant impediment to effective competition. Indeed, as it does so often in the case of market definition, the Commission may be tempted to leave open the question of whether the merger will create or strengthen a dominant position.

Thirdly, it can be expected that complainants will push the Commission to explore the limits of the reformulated test even where the Commission itself is reluctant to do so. The introduction of the expedited (“fast track”) procedure before the Court of First Instance, and litigants' successes in achieving the annulment of Commission clearance decisions⁶⁵ have emboldened complainants and made the Commission much more cautious in motivating its clearance decisions. The allegation that the Commission did not apply the correct legal test in reviewing a merger is easily leveled, so the Commission will be keen to avoid any impression that it has contented itself with applying only the traditional dominance test.

64 See amended Recital 25 (formerly Recital 21) of the Merger Regulation. (“The notion of ‘significant impediment to effective competition’ in Art.2(2) and (3) should be interpreted as extending, beyond the concept of dominance, only to the anti-competitive effects of a concentration resulting from the non-co-ordinated behaviour of undertakings which would not have a dominant position on the market concerned.”) The significance of this recital has been strengthened by the fact that Art.2(1) of the Merger Regulation has been amended to make explicit reference to the “objectives of this Regulation”. The Council has thus made it clear that the Commission has no greater powers than previously to challenge vertical or conglomerate mergers.

65 See Case T-156/98 *RJB Mining v Commission* [2001] E.C.R. II-337; [2001] 3 C.M.L.R. 15; see also Case T-114/02 *BaByliss v Commission*, April 3, 2003, not yet published.

63 Guidelines, para.4.

Lastly, there may even be situations in which the merging parties themselves prefer to try and steer the Commission away from applying the dominance test in favour of finding a significant impediment to competition, namely where a finding of dominance could have prejudicial effects for one of the merging companies in the terms of the application of Art.82 EC. It must be recalled that it was precisely this risk of "cross-contamination" that was one of the principal arguments of the proponents of replacing the dominance test with the SLC test.

As a result, one would indeed expect the Commission to give meaning to the new test and actively explore the limits of its new tool of unilateral effects analysis.

Will the introduction of unilateral effects analysis significantly impact the Commission's fact-finding methods? In particular, will we see a shift to US style, "high-tech" econometric analysis in the EU?

Unilateral effects analysis in the US has become increasingly sophisticated in recent years in terms of the econometric evidence that is offered by the parties and accepted by the agencies and the courts. While the starting point to assessing whether products are "close substitutes" will often be the examination of the merging parties' internal strategy and marketing documents and the depositions of the relevant business people, in critical cases the analysis almost invariably involves detailed economic modeling, provided that sufficient data is available.

For example, *New York v Kraft Gen Foods, Inc*⁶⁶ was a fully litigated merger in which econometric analysis played a significant role in assessing many key issues, including product market definition and unilateral effects.⁶⁷ The case involved complex methodological questions calling for significant experience in econometric analysis. The state, the acquirer Kraft and the District Court all retained expert econometricians. The Court was confronted with detailed econometric and qualitative evidence, including estimations of own-price and cross elasticity on the basis of weekly supermarket scanner data going back three years for 10 major metropolitan areas of the United States, data on household purchasing dynamics, and marketing studies showing patterns of consumer behaviour, including

"interaction indices."⁶⁸ With respect to market definition, the issue was whether the parties' ready-to-eat ("RTE") cereals were close substitutes because they could be classified as "adult" as opposed to "kid" RTE cereals. In the end, the Court agreed with the defendant that the market should be defined as including both "adult" and "kid" cereals, yielding an overall RTE market in which the parties' combined share was less than 15 per cent. Notwithstanding this low share, the court also addressed the plaintiff's contention that Grape Nuts and Shredded Wheat (key brands of the parties) were closest substitutes among differentiated products such that the merger could still produce adverse unilateral effects. In rejecting this unilateral effects argument, the Court found that "evidence, including consumer consumption and purchase information, and econometric evidence, shows that Grape Nuts and Nabisco Shredded Wheat compete with many other products and are not the first and second choices of a significant number of consumers".⁶⁹

Is it conceivable that the European Commission and the Community Courts will in the near future decide unilateral effects cases on the basis of such complex econometric evidence?

The Commission is evidently showing a growing interest in econometric analysis, as is illustrated by its recent *GE/Instrumentarium* decision. With the appointment of Lars-Hendrik Roeller, a recognised expert in antitrust economics and the use of quantitative techniques, as Chief Economist, this trend is bound to continue and possibly accelerate. Nevertheless, at least in the short to medium term, one must have serious doubts as to whether the use of econometric evidence before the Commission will reach the level of sophistication seen in US cases such as *Kraft*.

The main reason for scepticism in this respect is the institutional constraints under which the Commission operates, and for at least some of which there is no easy "fix".

Clearly, the statutory deadlines governing the EU merger review procedure impose some limits on the Commission's ability to perform extensive econometric analysis as compared to the more open-ended US process. However, the Commission has already found ways to "stop the clock" in some cases in which more time

⁶⁶ 926 F.Supp. 321 (S.D.N.Y. 1995).

⁶⁷ For a summary of the economic issues involved, see Rubinfeld, "Market definition with differentiated products: the Post/Nabisco Cereal Merger" (2000) 68 Antitrust L.J. 163.

⁶⁸ For example, the interaction indices showed a significant percentage of children that eat "adult" cereals and of adults that eat "kids" cereals.

⁶⁹ See n.66 above, 352. The Court also noted that the parties' low combined market share of 15% was below 35%, the minimum level mentioned in the US Guidelines for unilateral effects. *ibid.* at 366.

was needed for the collection and assessment of economic evidence, for example in *Volvo/Scania*⁷⁰ and *GE/Instrumentarium*.⁷¹ The CFI's pronouncements in the *Schneider* case⁷² suggest that the Commission has a large margin of discretion when it comes to using massive data requests to gain more time. Moreover, the revised Merger Regulation gives the Commission the option of extending the deadlines in complex cases if it requires more time for its analysis; this mechanism seems well suited for cases in which the Commission is presented with complex economic evidence on unilateral effects. If one adds the customary month or two of pre-notification talks, the time available to the Commission is not considerably shorter than the typical duration of a US second-request procedure.

The Commission's lack of resources would appear to impose a greater challenge. While the Commission does employ a considerable number of economists, including in those units that are now responsible for vetting mergers following DG Competition's internal reforms, few of them have extensive, Ph.D level training in antitrust economics or even econometrics. The rigours of the Commission's staff regulations do not allow it to operate the kind of "revolving door" policy that has allowed the US agencies to attract senior economists with considerable experience in private or industry practice. While the appointment of the Chief Economist substantially increases the level of know-how in this area, his tasks are many and he and his relatively small team (10 Ph.D level economists) are likely to be heavily occupied with oversight and co-ordination issues in merger and non-merger cases alike. It can thus not be expected that the Chief Economist and his staff will be able to devote substantial time to the details of econometric evidence in individual cases, in particular given the current practice that a member of the Chief Economist's staff joins the case team only in Phase II. While the Commission has in the past retained—and will no doubt continue to retain—outside experts to assist with the analysis or assembly of econometric studies, this is only a partial answer to the problem. Such experts are typically only retained at an advanced stage of the investigation and not deeply involved in the investigation itself. They thus have to work with whatever data and background information they receive from the case team rather than being able to help shape the investigation from the outset.

As long as there is a perception that the benefits (as well as the limitations) of using econometric evidence

are not well understood at both the staff level and within the DG Comp hierarchy, many companies may be hesitant to introduce such evidence. Some practitioners have offered the view that all too often, Commission staff pick and choose only those parts of the analysis that appear to bolster their case, while ignoring or "rationalising away" those data points that do not fit with the competitive effects story pursued. To what extent the Chief Economist will be able to impose the necessary degree of analytical rigour remains to be seen; as it is not currently contemplated that the merging parties will have direct access to him, the Chief Economist and his team may have to do a fair amount of detective work to uncover any methodological short-cuts in the staff's analysis.

A final issue that is somewhat troublesome in the Commission's handling of econometric evidence is its reliance on complainants, usually competitors. Whereas the US agencies and courts tend to view competitor complaints as an important indicator that a transaction will raise neither unilateral nor co-ordinated effects,⁷³ the Commission still seems to attach considerable weight to the substance of their complaints. As mentioned above, in *GE/Instrumentarium*, the Commission relied, at least in part, on an econometric study presented by Philips, a competitor of both GE and Instrumentarium in the market for perioperative patient monitors. According to the Decision, the win-loss data presented by Philips suggests that, "as a result of the merger, Philips would be likely to offer lower discounts and would therefore be less constrained when bidding in tenders."⁷⁴ If the Commission's analysis is correct, one certainly wonders why Philips would have gone as far as commissioning an extensive (and presumably expensive) econometric study in order to stop a merger that, according to its own economists, would actually boost Philips' margins by allowing it to decrease its discounts. One would hope that the Commission subjects such competitor studies to greater scrutiny in the future.

As regards *qualitative* evidence in unilateral effects cases, such as company documents and marketing studies allowing inferences as to what products could be considered close or distant substitutes, things look slightly better. The analysis of such documents is part and parcel of most Commission investigations and does not require the kind of specialist training that is necessary to perform multiple regression analysis or other

70 Case COMP/M.1672, March 14, 2000.

71 Case COMP/M.3083, September 2, 2003.

72 Case T-310/01 *Schneider Electric v Commission* [2002] E.C.R. II-4071; para.[94] *et seq.*

73 See, e.g. *Hospital Corp of America v FTC*, 807 F.2d 1381, 1391-92 (7th Cir. 1986) (Judge Posner asserting that the strongest argument that the merger was pro-competitive, and therefore lawful, was that the FTC acted in response to a complaint by the competitor.)

74 Case COMP/M.3083, September 2, 2003, para.[183].

quantitative techniques. Yet many practitioners still detect significant room for improvement in the Commission's investigative techniques. As far as the reliance on company documents is concerned, mistakes of the kind highlighted by the Court of First Instance in the *Airtours* case⁷⁵ should be rare, but one does occasionally detect a tendency by Commission staff to focus on isolated, potentially inculpatory statements without analysing the overall context and purpose of the relevant document. Similar concerns often are raised about the Commission's "market surveys". Such surveys frequently solicit respondents' opinions that go straight to the competition law issue in question (e.g. questions asking respondents to define a market), opinions that most respondents are not qualified to give and that in any event are no substitute for the investigation of the underlying facts. As a result, it is difficult to determine the foundation of a statement such as that in *Barilla/Kamps*: "According to estimates submitted by retail chains and competitors, consumers are significantly more likely to switch from Wasa to LiekenÜrkorn, or vice versa, in response to a price increase than to any other bread substitute product."⁷⁶

At least in the medium term, however, one should not be too pessimistic about both quantitative and qualitative evidence receiving proper treatment by the Commission. None of the constraints discussed above are insuperable, and it can be expected that the system of checks and balances recently instituted within DG Competition—such as peer-review panels, the Chief Economist, and an enlarged role for the Hearing Officer—will have some effect. The explicit recognition in the amended Merger Regulation of the Commission's power to interview business executives from the merging parties as well as third parties may encourage Commission staff to emulate the kind of searching discussions that the US agencies engage in with competitors and customers to probe their responses and underlying motivations. Significant improvements should be possible within a short time-frame if the Commission staff shows somewhat greater openness in discussing methodological questions both internally and with the parties. In this context, it is an encouraging sign that in *GE/Instrumentarium*, the Commission reportedly allowed the merging parties' economists—on the basis of a strict confidentiality agreement—to review complainants' econometric analysis and underlying confidential bid-data and to submit a critique of this analysis to the Commission.

As far as the use of complex econometric and qualitative evidence by the *Community Courts* is concerned, one should perhaps be somewhat more skeptical. In *Airtours*,⁷⁷ and even more so in *Tetra Laval*,⁷⁸ the Court of First Instance did engage in a fairly detailed review of documentary evidence, and in both cases based its annulment of the respective Commission prohibition decisions at least in part on the Commission's misreading of third-party market studies. It is also heartening that the Court did so in the *Tetra Laval* case despite deciding it under the constraints of the so-called expedited ("fast-track") procedure, which illustrates that there need not necessarily be a trade-off between a ruling that comes in time to allow the parties to salvage their transaction, and the kind of in-depth review that is appropriate for fact-intensive cases.

However, despite its relatively detailed review of documentary evidence in *Tetra Laval*, the CFI clearly preferred not to get involved in a debate between the parties' economic experts as to whether or not the bidding study and multiple-regression analysis submitted by the applicant revealed past price-discrimination by one of the merging parties. Rather, the Court simply stated that the Commission has a wide discretion in such matters.⁷⁹ Given that in *Tetra Laval*, the Court had ample other grounds to annul the Commission's prohibition decision, and that the evidence of past price discrimination was only a relatively minor point in the Commission's decision and the Court's judgment, one should not read into the judgment a general refusal to engage in a thorough examination of econometric evidence in a unilateral effects case where such an examination is outcome-determinative. Of potentially greater concern is that the Commission has appealed the Court of First Instance's judgment in *Tetra* on the basis that the Court of First Instance overstepped the proper boundaries of judicial review and substituted the Commission's assessment of complex facts with its own, rather than merely verifying whether the Commission had committed a manifest error and thus exceeded the discretion it has for making such assessments.⁸⁰ If the Court of Justice were to uphold the Commission's appeal on this point, this may well have a chilling effect on the Court of First Instance's willingness to make its own determination as to whether the Commission properly interpreted the econometric evidence before it. This in turn may affect the merging parties' willingness to stake their

75 Case T-342/99 *Airtours v Commission* [2002] E.C.R. II-2585; [2002] 5 C.M.L.R. 7, paras [90] and [102].

76 Case COMP/M.2817, June 25, 2002, para.[34].

77 See above, n.75.

78 Case T-5/02 *Tetra-Laval v Commission* [2002] E.C.R. II-4381; [2002] 5 C.M.L.R. 28.

79 *ibid.*, para.[119].

80 See Commission Press Release IP/02/1952, December 20, 2002.

case before the Commission on econometric evidence, at least in cases where there is a realistic possibility of judicial review that could have a disciplining effect in the administrative procedure.

In conclusion, one would expect that it will take some time before we see widespread use of the kind of "high tech" econometric analysis that is now routinely performed by the US agencies and increasingly also by the US courts in unilateral effects cases. Certain growing pains are inevitable, and much will depend on whether the merging parties feel confident enough that the Commission staff has the ability and willingness to properly handle econometric evidence, and that submitting such evidence will not have a materially negative impact on appropriate oversight by the hierarchy and the chances of obtaining meaningful judicial review.

Ultimately, will the introduction of unilateral effects analysis lead the Commission to intervene against mergers where it would not have considered such intervention previously?

While the issues considered above are clearly of significance for any interested observer of Community merger policy, the question that most concerns industry is obviously whether the introduction of unilateral effects analysis will actually lead to increased enforcement by the Commission. This is the question of the "enforcement gap" that has already been alluded to repeatedly in this article and that accompanied the debate as to whether the dominance test should be changed to the SLC test. Now that the Council has taken the decision to include unilateral effects analysis in the Merger Regulation, albeit not under the label of the SLC test, it is worth taking a fresh look at this issue.

It is submitted here that as a conceptual matter, there clearly is such an enforcement gap because the dominance test (understood as extending to both single and collective dominance) does not cover some scenarios in which the unilateral effects test would allow a merger to be challenged.

The threshold question of whether the notion of dominance could as a legal matter be interpreted to include all forms of unilateral effects is an interesting one, but one that shall not be examined here given the legislative change that has in fact occurred. Suffice it to recall that the very term "dominant position", as well as the interpretation of the Merger Regulation by the Community Courts⁸¹ would appear to exclude the

extension of the concept of single dominance to situations in which the combined entity is not by some measure the market leader in a properly defined market. As regards collective dominance, the strict requirements laid out by the Court of First Instance in *Airtours*⁸² should leave little doubt that absent a material risk of tacit collusion in light of market characteristics, the concept of collective dominance cannot be invoked, which implies that the collective dominance concept cannot be extended to a unilateral effects-type analysis. The very reasons for the Court of Justice's willingness in *Kali-Salz*⁸³ to interpret the Merger Regulation to encompass collective dominance—an analogy to Art.82 EC—militate against a further extension of the scope of the Merger Regulation, as Art.82 EC plainly does not cover unilateral-effects type price increases or output reductions by non-dominant companies.

If one accepts—as it is submitted here—that unilateral effects and dominance analysis are conceptually different, there may still be ways of applying the dominance test such as to cover most unilateral effects-type scenarios in practice. This is best demonstrated on the basis of the famous *Heinz/Beech-Nut* case⁸⁴ (also widely known as "*Babyfoods*"), the most frequently cited example of a "gap case". *Babyfoods* concerned a merger of the number two and three producers of baby foods, the clear leader being Gerber with 65 per cent market share. Whereas Gerber's baby foods were always stocked by supermarkets, Heinz and Beech-Nut usually competed for the number two "slot", as supermarkets typically carry only two different brands of baby-foods.

The first possibility of applying the dominance test to this type of fact pattern is to consider whether the conditions for a finding of collective dominance (or co-ordinated effects) are met. Indeed, in *Babyfoods*, the Court of Appeals preliminarily enjoined the merger in part based on a presumption of co-ordinated effects that would likely result at the retail level, since the merger would reduce the number of competitors from three to two.⁸⁵ However, in markets that do not exhibit a sufficient level of concentration and other market characteristics that are typically conducive to co-ordinated effects, for instance where products are complex and highly differentiated, or the market is characterised by rapid innovation, recourse to collective dominance is not available.

82 Case T-342/99 *Airtours v Commission* [2002] E.C.R. II-2585; [2002] 5 C.M.L.R. 7, para.[62].

83 Case C-68/94 *France v Commission* [1998] E.C.R. 1375, paras [165] *et seq.*

84 *FTC v H.J. Heinz Co*, 246 F.3d 708 (D.C.Cir. 2001).

85 *FTC v H.J. Heinz Co*, 246 F.3d 708 (D.C.Cir. 2001).

81 See, e.g. Case T-102/96 *Gencor v Commission* [1999] E.C.R. II-753; [1999] 4 C.M.L.R. 971, paras [123] *et seq.*

The second possibility would be to define the market narrowly so as to include primarily the parties' products, with the consequence of arriving at market shares that are high enough to lead to a presumption of single dominance. For example, if the Commission were to look at the fact pattern of the above mentioned case *New York v Kraft Gen Foods, Inc*⁸⁶ concerning RTE cereals, it could have defined a market for "adult RTE cereals" on which the merging parties may have had a substantial enough market share to qualify for single dominance. In a *Babyfoods* type scenario, the Commission could try to define a separate market for "second-line babyfoods" in which the merged entity may hold a high enough combined market share to be presumed dominant.⁸⁷ However, "drawing a circle" around the merging parties in this way sits uneasily with the traditional dominance test, which is to a large extent focused on rivals' continuing ability to compete. And there can be no doubt that the ability of the market leaders in both the *Babyfoods* and *Kraft* cases to compete, e.g. through product-line extensions, would not be significantly affected by the merger of competitors with a lower combined share on a somewhat more broadly-defined market. To the extent that defining a narrow market has the rather obvious purpose of capturing localised competition under the guise of "dominance," there would seem to be a considerable risk that the Commission could not convince the Community courts that this is a proper approach.

A third possibility, pointed out by *Levy*,⁸⁸ would be to argue that the merger of the number two and three players strengthens the dominant position of the leading player by further decreasing the competitive pressure it faces. Indeed, the Commission has in exceptional cases taken the view that the Merger Regulation extends to situations in which a merger leads to the strengthening of a dominant position that is held by a company other than the combined entity (either alone or as part of collective dominance with another company).⁸⁹ However, the successful use of such an argument in a unilateral effects type scenario would have to overcome a significant number of challenges. The Commission's approach as to the strengthening of a third party's

dominant position has not yet been tested in the Community courts, as the Commission itself has acknowledged.⁹⁰ Moreover, it would be questionable whether the removal of some residual pricing pressure from the market leader would be sufficient to reach the materiality threshold for finding a strengthening of a dominant position; the Commission itself recognised that not any minimal increase in market power is sufficient even in the case of pre-merger dominance.⁹¹ Finally, and this is perhaps the greatest limitation, the Commission would have to show that the market leader already holds a position of single dominance, which will be difficult if the distance between the market shares of the market leader and merged entity is small.

In conclusion, at least at a conceptual level, it is undeniable that barring an improper extension of the dominance test, there was indeed an "enforcement gap" under the traditional dominance test that has been closed by the explicit recognition of unilateral effects analysis. The stylised facts of such a scenario can be described as follows: the merger of the number two and three competitors whose products are close substitutes and which have a substantial combined market share but still lag behind the market leader, in a market whose general characteristics are not such as to give rise to co-ordinated effects, and which moreover does not easily lend itself to the definition of separate sub-markets that would encompass only the products of the merging parties.

How often such a fact pattern occur in practice is a difficult question to answer. *Kolasky* and *Elliott* have argued that a survey of merger challenges brought by the Justice Department and the FTC under the SLC test would find very few cases in which the combined market shares of the parties did not exceed 40 per cent (a region in which a finding of single dominance becomes a realistic possibility) and in which there was not a "good co-ordinated effects story of the kind that would meet the requirements for collective dominance under EU law."⁹² But, as the saying goes, "it is difficult to make predictions, especially about the future," and common experience among practitioners and academics is that even the most imaginative mind rarely anticipates what business reality will present next. There can thus be little doubt that the first "gap case" is just around the corner.

86 See n.66 above.

87 In establishing a *prima facie* case for a preliminary injunction against the merger, the *Babyfoods* Court relied in part on the elimination of competition among the "only two competitors" for the "second shelf" position. See n.84 above at 717.

88 *Levy*, *European Merger Control Law* (2003), para. 10.04[6][c].

89 See Case IV/M.1383 *Exxon/Mobil*, September 29, 1999, paras [225]–[229]; see also Case COMP/M.2353 *RWE/Hidroeléctrica del Cantábrico*, March 19, 2002, para.[10].

90 *Exxon/Mobil*, paras [226] and [229].

91 See, e.g. Case IV/M.997, *Swedish Match/Ka*, December 18, 1997.

92 *Kolasky & Elliott*, "The European Commission Notice on the Appraisal of Horizontal Mergers" (2003) *Antitrust* 64–69 at p.64.