TOWARDS FURTHER REFORM?

An Examination of the Legal Framework and Practical Capacity of the European and U.S. Federal Authorities to Regulate Mergers in Current Global Market Conditions

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1. A MERGER BOOM

In February 2000, the largest merger ever was concluded between Vodafone Air-Touch and Mannesmann[1]. Aside from the ramifications of this merger for the communications sector in Europe, and world-wide, there are other potentially huge effects on market structure. Some have suggested that this deal may throw open the 'corporate doors' of Europe, setting the scene for a new era of cross border mergers and acquisitions.

Such enormous mergers and acquisitions are by no means a new phenomenon in Europe, and in the US they have played an important role in many sectors of the market for over a hundred years. If one looks at the number of European companies that have been involved in such agreements in the last decade, it can reasonably be said that a merger boom has occurred, and is continuing to occur.

1.1 Reasons Behind the Current Frequency of Mergers

Many reasons are suggested for the current frequency of mergers. The threat of recession has loomed over many sectors of the global economy, particularly in manufacturing industry. As returns have dwindled, these corporations have had to look harder for means to remain profitable. The FTSE 100 Index listing for the second quarter of 2000, has seen several manufacturing concerns, that have been immensely profitable in the past, displaced by 'New Technology' corporations. This displacement usually results in a reduction in trading, with a corresponding reduction in market value, and a knock-on effect on investor interest. Traditional 'blue-chip' companies are beginning to 'feel the pinch', and consolidation by merger is one means of survival.

[1] Vodafone Air – Touch's bid of £113bn for its German rival, will create a group valued at £228bn, which would be Europe's largest publicly traded company, the world's largest telecommunications group and the fourth largest corporation in the world. Source: FT 4/2/2000

The frenzied activity is not limited to these traditionally profitable sectors of the economy. The 'New Technology' sector has also recently seen furious activity in terms of corporate mergers, acquisitions and restructuring. Many have noted that large numbers of these companies are not generating profits, and that their high market capitalisation is artificial, due to heavy trading because of their being the 'flavour of the month'. Some analysts argue though that these activities, in the communications and information technology industries, are aimed at longer-term goals. The argument is that they form part of a widely held desire in the corporate world to take full advantage of the opportunities to profit presented by the burgeoning global market for these products and services, notably in the areas of internet service provision and e-commerce.

Another motivating factor for merger activity has been a desire to capitalise on the opportunities presented by the opening up of global markets. Companies have merged or acquired other undertakings in order to enlarge and consolidate their operations, increasing output or quality of service, in order to compete on a multinational basis. This has been seen all across the European financial services sector with undertakings merging with competitors, a notable example being RBS and NatWest[2]. The most recent example of this trend is Deutsche and Dresdner Bank's move. If this agreement eventually meets with the approval of European regulators[3], it will create a group with combined assets of EURO 1,250 billion, the second largest financial services group in the world[4]. These consolidation mergers have been a major feature of the US financial sector in recent years, and it seems likely that more of the same will follow in Europe.

Other valid reasons have been suggested for this merger boom. Whilst at the minute many national markets are enjoying a period of growth driven by the US economy's strong performance, many other countries, and indeed some sectors of the economy in general, are showing signs of a slowdown in growth[5]. Some have suggested that, as a result of comparatively poor returns on investments, many large

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[2] Both pre-merger firms boasted strong links to other banks in Europe. RBS's share price was supported by one of these, Banco Santander, during the negotiation process

[3] It will be interesting to see if the 'two-thirds' rule has any bearing on this merger. See further discussion, Chapter 3, below

[4] FT 8/3/2000

[5] So saying, the Federal Reserve Bank has warned that the US economy may be showing signs of overheating. FT 9/3/200

scale and institutional investors, whose holdings give them enormous power, have been exerting pressure on corporate management to deliver profits by whatever means necessary[6]. Participation in merger transactions is one course of action to 'artificially' increase the market values of floated companies, and satisfy investor demands. Some more cynical commentators have pointed the finger at mutual fund managers, who are generally paid on the basis of their fund returns, and as a result it is in their best interests to exert any influence they can on corporate management to raise share prices by whatever means available.

It would seem that the merger is increasingly becoming a tool of corporate management to be utilised in order to maintain long-term profitability. However the prevalence of mergers in the global markets of today does raise important questions as to whether effective competition will survive or not.

[6] Institutional investors are being forced to do this by their need to continue paying out to an aging population across the western world. Their influence has been instrumental in brining about such mergers, an example being Allianz in the Deutsche-Dresdner transaction

2. THE NEED FOR REGULATION – EFFECTS ON COMPETITION

Modern economic theory is based on the premise of ‘perfect competition’. This somewhat idealised concept provides the foundation upon which the competition law systems of the world are built. It assumes that there are a large numbers of buyers and sellers in any given market, where the latter all produce homogenous or identical products. Furthermore, it assumes that consumers have perfect information, that the parties will always act to maximise the economic utility of their resources, that resources will flow freely between various areas of economic activity and that there are no impediments to new competition, known as ‘barriers to entry’. A system of ‘perfect competition’ is the opposite of a monopoly system, and is commonly thought to offer the most effective and efficient use of economic resources.

It was recognised at an early stage that the real world simply did not correspond to this model[7]. Business could, and often would, co-operate rather than compete. The need to regulate markets, to bring the reality closer to the ideal was realised and since the late 19th century, there has been a body of laws in existence in order to curtail such anti-competitive behaviour[8]. A further motivating factor for this market regulation was to keep open opportunities for greater competition, particularly involving small and medium-sized companies, thus improving, as well as preserving, real choice for consumers.

Merger regulation has the same fundamental rationale behind it. The effects on competition of mergers are fairly obvious, as they are one way of acquiring dominance in a particular market, or indeed a means for a firm to diversify into other markets where its size can give an advantage in trading. Such behaviour can bring market conditions closer to a monopoly situation, which is traditionally viewed as undesirable. Thus many jurisdictions throughout the world seek to regulate the occurrence of mergers where they will result in a greater degree of market concentration, and have potential anti-competitive effects.

[7] One assumption that can generally be relied on as fact is that business will always act to maximise profits
[8] The original Competition law legislation, was the USA’s Sherman Act (1890)

2.1 Classification of Mergers

Generally speaking a merger can be deemed to have occurred where two firms that have previously been separate come under common ownership or control, whether this is by the acquisition of a number of an undertaking's shares by another, or a consolidation of corporate identities and assets. However, contemporarily, the notion of a merger is drawn so broadly, that the mechanics of its occurrence have little effect in determining its legality.

Mergers can be simply classified by their nature and the pre-existing market positions of their parties. They are deemed 'horizontal', if they occur between firms engaged in the manufacture or provision of goods or services that are identical or close substitutes, who trade within the same geographical market. Essentially this means that 'horizontal' mergers are those occurring between undertakings who were competitors prior to their merger agreement. Understandably they are seen as the most dangerously anti-competitive type of merger.

A transaction between parties acting at different levels in the chain of supply of a common product or service is dubbed a vertical merger. A certain level of vertical integration is arguably necessary in every firm to minimise production costs. Vertical mergers are only one way of doing this, but they are regarded as the most efficient. Vertical mergers are still viewed as being potentially anti-competitive, and as such fall under the regulatory powers of the law.

A 'conglomerate' merger occurs where the parties to the agreement are involved in the production of separate products. However competition law does not generally concern itself with 'pure' conglomerate mergers, as described here. Rather, competition authorities have concerned themselves with conglomerate mergers where firms stand in a relatively close market relationship with each other. These transactions are where firms, rather than being in direct competition, as with horizontal mergers, produce complementary goods or services. The US and European competition authorities and the relevant courts seem to have taken the position that conglomerate mergers do not present the threat to competition that were once considered to.

2.2 The Chicago School

The Chicago school of economic thought has been the driving force in shaping current political attitudes to merger regulation in the US, and arguably to a lesser extent the EU. The view proposed by Chicago school economists is opposed to the traditional approach, that concentration in industry is economically harmful and the attitude that 'bigness is bad'. Since its reemergence, in the latter half of the 20th century, the *laissez-faire* approach this school of thought subscribes to, has gained a great deal of ground over the traditional position, particularly in America.

Their view is that the situation prevailing in the real world approximates fairly well to the perfect competition model. They see monopolies as not in themselves anti-competitive, providing there are no barriers to entry in the marketplace. Barriers will only arise if the operation concerned cannot be carried out below a minimum efficient level that is not feasible for new entrants to the market to reach. So there is no need to regulate the market for any reason other than blatant anti-competitive conduct, as in other circumstances it is perfectly capable of regulating itself.

These principles can be applied to the processes of merger regulation. Where a merger creates an entity whose size is such as to generate efficiency savings that essentially bar market entry by new competitors, then there is a clear need to intervene. Failing this, then the transaction, given its potential to maximise profit and efficient use of resources, should be allowed to occur. Furthermore, they feel that merger transactions can serve to keep the capital markets happy, by bolstering share prices.

Whilst the economic rationale of the Chicago school would seem to be justifiable, the motives may not. The fundamental principle that 'bigness is not bad' is a reasonable proposition, insofar as it allows for the best use of possible 'economies of scale'. A minimalist approach to merger regulation is understandable in this light, in that it allows companies to restructure and grow in size to gain efficiency savings. Their opinion is that competition should be viewed as a global issue in the modern context, with mergers being encouraged so as to foster a spirit of ‘economic nationalism’.

Many commentators, rooted in the traditional approach, have questioned both the applicability of these principles economically, and the motives behind them. Professor Milton Friedman’s research at the University of Chicago, was funded by Amoco, a petrochemicals giant, as well as other major corporations. It was seen, in part, as a counter attack against the aggressive enforcement of antitrust law in the U.S.A. in the post-war period that carried on into the 1960’s.

As governments came and went, it is suggested, politicians became less concerned with the economic ideals of perfect competition, and more susceptible to the charms of big business. The knock-on effect was a drop in enforcement. More people tried to bend the antitrust rules, with some success. Presidential judicial appointments in the US Federal courts also helped contribute to this decline. Nevertheless, the competent US Federal authorities remain fairly true to the ideas that inspired the original body of law, and are proactive in pursuing Antitrust actions, particularly where mergers are at stake. Despite this, there can safely be said to have been a marked decline in real enforcement over the last quarter of the 20th century.

3. MERGER REGULATION IN THE EUROPEAN COMMUNITY

The laws seeking to regulate the anti-competitive effects of mergers in the European Community are a result of the perception of the competent authority, Directorate General IV (DGIV) that there was a gap in their powers[9]. From their wording, Articles 85 and 86 of the Treaty of Rome seemed not to apply to mergers, and no powers were specifically conveyed on the Commission to regulate such matters[10]. Indeed, at the time of the Treaty of Rome's negotiation, none of the then Member States had explicit national measures for regulating mergers.

3.1 The *Continental Can* and *Phillip Morris* Cases

The Commission concluded in 1966, that whilst Article 85 certainly did not apply in this area, Article 86's provisions were capable of applying to merger agreements[11]. Until 1972, the Commission had not adopted this position in its operations in the field. In its initial proceedings against the Continental Can Co., the Commission not only took action against the specific concentration at issue, but also sought to develop the principle that it could regulate mergers under the provisions of Article 86. This principle was upheld, following appeal, by the European Court of Justice (ECJ) in February 1973 in the *Continental Can* judgement[12]. This case established the broad principle that a company with a dominant position could be regarded as abusing its position, in breach of the Article 86 prohibition, by taking over a competitor. Despite this expansive interpretation of Article 86's application, the Commission lost the case, as it had failed in the ECJ's opinion to satisfactorily identify the relevant market.

[9] DGIV has been renamed the 'Competition Directorate' under the Prodi Commission's reforms. For reasons of clarity, and conciseness, it will be referred to by its original title.
[10] The Treaty of Amsterdam has renumbered these Articles 81 and 82 respectively
[11] 'Memorandum on the Problem of Concentration in the Common Market' European Commission, 1966
[12] *Europemballage Corporation and Continental Can Co. Inc. v. Commission*, Case 6/72

Continued failure to introduce a coherent framework for regulation led the Commission in the mid-80's to change its approach, focussing its proposals on Article 85, a basis for regulation which it had previously dismissed. This was questioned by the *Phillip Morris* case[13]. In this case, the applicants complained against agreements made between Phillip Morris and Rembrandt Group Ltd., competitors in the tobacco market. The ECJ ruled that Article 85 could apply if the concentration occurring was the result of agreements entered into by companies. This served to create the possibility of merger regulation based on the Article 85 prohibitions on cartels and other restrictive agreements, but as with the *Continental Can* case, the judgement failed to create a clearly defined regulatory regime for mergers.

3.2 Creating the Merger Regulation

The matter of greatest dissent in the negotiations prior to the adoption of the Merger Regulation was the threshold level required of the merging parties' turnover, above which the matter became the responsibility of the European Community. Larger states, with systems of merger regulation in place, such as France, the UK and Germany sought that this threshold be set at a high level, so as to cede as little sovereignty as possible. Smaller states, notably the Netherlands which had no national system of merger regulation, sought lower thresholds, in order to catch as many transactions as possible. They were of the opinion that given the smaller size of some of their national economies, mergers of a smaller size could have as great effects on competition within those nations, as those of larger value. The smaller size of these states also had the effect of their being more willing to recognise that the relevant market was the European one, particularly given that economic conditions within their countries meant that the home market was unable to sustain effective competition in certain important sectors.

The concerns of these smaller states were shared, quite logically, by businesses all across the Community. Lower thresholds were in their interests as, given the fact that regulation was likely to occur to some extent anyway, it was desirable that the process should be as consistent, simple and efficient as

[13] *British American Tobacco Co. Ltd. v. Commission* and *R.J. Reynolds Industries Inc. v. Commission* (joined cases 142/84 and

possible. Their hope was that the idea of an EC merger regulation creating a 'one stop shop' system should be taken to its logical conclusion, minimising the need for multiple filings before national competition authorities.

3.3 Regulation 4064/89 and the Process of Amendment

The resulting Draft Regulation was put before the Council on 31/3/89, and was agreed to after protracted negotiations and the element of 'horse trading' that was, and is, almost always a feature of the unanimous decision making procedure. The result was Regulation 4064/89. Its legal base was in neither Article 85 nor 86, but rather in Article 235, which empowers the Council to accept a Commission proposal if it is in the interests of attaining a stated Community objective[14]. The regulation mirrored the long-standing concerns held in the U.S.A. as to the anti-competitive nature of concentrations in industry. The thresholds included in the merger regulation were a compromise, but erred on the high side. Even so, some still considered its application to be too broad.

A more widely held view was that its scope was too limited. The turnover thresholds were seen as severely restricting the application of the regulation and the Commission expressed an intention to reduce the thresholds early on[15]. This process took longer than the Commission expected. It published a Green Paper on the review of the Merger Regulation's operation in 1996[16]. Again, after an extensive consultation and review process, the Council passed a Regulation that had the effect of reducing the level of the turnover thresholds[17].

156/84)

[14] Now Article 308. The Community objective is Article 3(g) of the Treaty.

[15] They wished the review to occur by the end of 1993. This announcement was treated with great scepticism by commentators, given the opposition by Member States. 1995 seemed more realistic (Graham and Prosser "European Merger Control", NCC)

[16] "Community Merger Control – Green Paper on the Review of the Merger Regulation" , COM (96) 19 final, Brussels, 31/1/96

[17] Regulation 1310/97. Hereinafter the 'Amended Merger Regulation' (AMR). It also affected other aspects of the Regulation's operation, of which see below. It came into force on 1/3/98, some time behind the Commission's timescale.

3.3.1 The Regulatory Framework: The 'Community Dimension', the 'Two-Thirds' Rule

The AMR operates on a regulatory framework which brings agreements that have a 'Community dimension' within the jurisdiction of the Merger Task Force (MTF) of DGIV. Rather than actually reducing the threshold level, the AMR introduces a lower test of turnover for mergers which did not meet the pre-existing standards[18].

Mergers have a Community dimension where the parties have a combined aggregate worldwide turnover of ECU 2.5 billion and the aggregate Community-wide turnover of at least two of the undertakings concerned is more than ECU 100 million. Furthermore, in each of at least three Member States, the combined aggregate turnover of all the undertakings concerned must be more than ECU 100 million and in each of these three Member States, the aggregate turnover of at least two of the undertakings concerned is ECU 25 million[19].

This inclusion of a lower threshold is limited by the 'two-thirds' rule, which states that a merger does not have a Community dimension where "each of the undertakings concerned achieves two-thirds of its aggregate Community-wide turnover within one and the same Member State"[20]. This rule was heavily criticised at the time of the original Regulation's adoption, for excluding a significant number of mergers. It was seen as particularly restrictive where it prevented the MTF from intervening in cases stemming from Member States with no effective mechanisms of merger control. Many were of the opinion that when reform came it should include changes to this provision, an entirely understandable argument. The exclusion of a merger from the 'one stop shop' system on these grounds will probably require at least one national filling, regardless of the size of the merging parties. Given the often large size of the parties involved in merger agreements, operations with a significant effect on competition at a Community level may be overlooked by such exclusion. Also, the size of the merging parties operations may require

[18] Article 1(2) AMR
[19] Article 1(3) AMR
[20] Article 1(3) AMR

multiple filings in other Member States as a result of their turnover there, even if in total it does not amount to more than a third of the aggregate Community value.

3.3.2 Calculation of Turnover

The requirement of turnover is calculated on the basis of Article 5. This can be a massively complex task given the size of the undertakings involved. Where the merger relates to the acquisition of parts of an undertaking, only the turnover relating to those parts acquired is included in the calculation. If there have been a number of such transactions within a two-year period between the same undertakings, DGIV will treat them as the same concentration, on the date of the last transaction[21].

The turnover calculation includes that arising from any undertakings over which a party to the transaction has *de jure* control. However, as is often the case, the parties may very well have *de facto* control over other undertakings given the diverse nature of ownership that occurs in public companies. As such the turnover could be underestimated and mergers with potentially anti-competitive effects may slip through. Even so multi-national corporations may be subject to the provisions of the regulation, by virtue of their turnover within the Community, even if they have little or no assets within it[22].

The 1997 amendment also provides for an improved method of calculating the turnover of financial institutions involved in mergers. It gives a more specific and detailed list of the incomes from investments that should be included[23].

3.3.3 Notification and Assessment

There is a requirement of prior notification of mergers with a Community dimension[24]. It must take place no later than one week after the conclusion of the agreement to merge or equivalent. In the event of a

[21] Article 5(2) AMR
[22] See *Gencor/Lonhro*, Case IV/M.619; *Boeing/McDonnell Douglas*, Case IV/M.877

merger this notification is to be carried out jointly, and in the event of an acquisition it is the responsibility of the acquirer.

Article 6 deals with the MTF's examination of notifications, and Article 8 with its powers of decision. Notifications must be examined on receipt. An initial assessment is made. If the merger falls outside the Regulation, the Commission must record this by decision. If the notified agreement falls within the Regulation's provisions, the Commission will then publish the notification and the firms involved. If there is a Community dimension, but the merger does not pose any anti-competitive threat, then the Commission publishes a decision declaring compatibility with the Common Market. If the Commission deems the merger to be incompatible with the Regulation's prohibitions, then it will either gain commitments from the parties to alter the agreement so as to minimise its anti-competitive effects. These decisions must occur within one month, but the MTF may initiate further investigations which must occur within a further three months.

The parties are prevented from implementing the agreement until the MTF has rendered a decision declaring it compatible with the Common Market[25]. By far the majority of mergers are dealt with in the first phase of assessment without further investigation[26]. This small delay can be costly for the undertakings concerned given the stupendous sums involved in interest payments, and other transaction costs.

Article 2 of the Regulation deals with the MTF's appraisal of concentrations for the purposes of establishing any anti-competitive consequences. DGIV have general goals of maintaining competition, protecting economic and technological progress and having regard to potential barriers to entry in markets. All the while they have a stated goal of acting as far as possible in the interests of the

[23] This calculation remains far from straightforward
[24] Article 4 AMR
[25] Article 7 (1) AMR
[26] Of the 1168 cases notified in the period between 21/9/90 and 31/10/99, 1046 were dealt with in the first phase. 931 were seen as compatible with the Common Market. 44 were compatible with commitments to alter the agreement. 50 were outwith the Regulation's scope. 21 were referred to national competition authorities. (Statistics, European Merger Control – Council Regulation 4064/89, European Commission)

intermediate and ultimate consumers. Their approach is generally similar to that taken by the American authorities, of which, see further below.

Article 3 defines the kinds of agreements that are treated as concentrations. This is drawn broadly, including mergers and acquisitions, with an amendment clarifying the position relating to joint ventures. Temporary holdings by financial institutions and assets held during insolvency proceedings are exempt.

The Regulation itself gives no guidance on how the Commission should go about defining relevant markets, which is surprising given the importance of market definition in the assessment of merger cases. There is a well-developed body of law in this area stemming from the Commission's decisions on Articles 85 and 86, and ECJ judgements. Nevertheless, the Commission, appreciating the need for consistency and clarity, published a Notice, detailing the way in which makes its analysis of the relevant product or service, and geographic markets[27].

In completing the notification form the notifying parties are asked to identify 'affected markets'. This nomination does not bind the Commission. Ordinarily, the undertakings involved will attempt to draw the market definition as broadly as possible so the combined market shares will be lower. The MTF will seek a narrower market definition, in order that the market shares are larger, so as to ensure any potential anti-competitive effects are minimised.

In its economic analysis of concentrations, due to the time limits, the MTF gives greater emphasis to demand-side substitutability of the products concerned. They will look to the essential physical characteristics of products, their intended use, their prices, the nature of the buyer and the marketing process[28]. In further, more probing investigations, the more complex issues of supply side substitutability are considered in depth as well, when time is not as great an issue.

[27] 1997 OJ C372/5, 9/12/97

[28] see further *Aerospatiale-Alenia/de Havilland*, Case IV/M.053, *Renault/Volvo* Case IV/M.004

3.3.3 Powers of the Commission over Mergers Incompatible with the Common Market

The Commission, on completion of any further investigations, renders a decision either deeming the merger compatible or incompatible with the Common Market[29]. In the latter case it may attach conditions or obligations to ensure that the undertakings make the accomplishment of the merger compatible with the Common Market. The same applies if the merger has already occurred[30]. It may also prohibit the merger[31]. These Commission powers are backed up by a power to issue periodic penalty payments of up to ECU 100,000 per day for non-compliance.

Article 14 deals with fines for breaches of the rules contained in the Regulation. In the event of a firm ignoring a Commission decision or implementing a concentration in breach of the Regulation, either intentionally or negligently, DGIV has a power to levy a fine of up to 10% of the aggregate turnover of the undertakings concerned, having regard to the nature and gravity of the infringement. Given the fact that the jurisdiction of the Commission in these matters covers the very largest of merger agreements between huge corporations, these fines have the potential to be staggeringly large[32].

The ECJ retains an unlimited jurisdiction to review any decision of the Commission where fines have been issued, and may vary these if it chooses. There is also a possibility of appeal before the Court of the Commission's decision, if the usual procedural pre-conditions are met.

3.4 Truly a 'One Stop Shop'?

When the Commission's report to the Council on the functioning of the new thresholds and other aspects of the reformed Regulation is published (before July this year) it will make interesting reading.

[29] Article 8 AMR
[30] i.e. the Commission can compel firms to restructure, post-merger
[31] Although it has only made 11 decision to this effect, from the 1168 case notified.
[32] Fines for failure to comply with the notification requirements are considerably smaller than those issued under the American system. Article 14 limits them to ECU 50 000, but they can be as low as ECU 1000. See Chapter 4, below.

Following this report, the Council may revise the new thresholds and criteria, by qualified majority voting. The 1997 reforms, whilst they did admirable work in tidying up procedures and timetables, and providing explicit legal bases for certain aspects of the MTF's administrative practice, did not seem to adequately extend the application of the Regulation.

This is perhaps due to the lack of political will to extend the application of the Regulation dramatically, explained, at least in part, by a desire to retain sovereignty over this economically sensitive matter. A majority of Member States rejected any substantially lowering of the existing thresholds, arguing that, in real terms, with the passage of time, the thresholds had been lowered anyway. Furthermore, they argued that the geographical expansion of the Community since 1989 and the growth in the turnover of business generally had made it easier for firms to meet the turnover thresholds, effectively reducing them.

The negotiation period prior to the reform saw many convincing arguments advanced for the extension of the scope of the Regulation, principally from industry, who lobbied for the extension of the 'one stop shop' procedure to include any transaction which would otherwise fall under the scope of at least three merger control regimes at a national level. This idea was not pursued for practical reasons, and the purely turnover-based approach was taken.

Estimates of the actual effect of the reforms varied widely between the parties. The Commission believed that eight additional concentrations would be subject to the Community regulatory framework, whilst the UK estimated that there would be 26 more transactions reported annually. The reality is that in the reformed system's first year in operation, 1998, there were 235 cases notified, an increase of 63 on the previous year. In the period 1/1/99 – 31/10/99 there were, in total, 232 notifications[33]. Whilst these increases can clearly not be attributed entirely to the extension of the scope of the Regulation, the figures still suggest that it has had some effect in increasing the enforcement of merger control by the Commission.

The new thresholds do afford greater opportunity for undertakings to make a single filing, serving to cut transaction costs, and introducing a greater element of certainty than that under varying national assessment standards. Yet despite the increases in the number of notifications, it seems that only a relatively small number of undertakings have been affected given the frenzied merger activity since the reforms were implemented.

On the other hand, the introduction of the new lower thresholds will mean that in the case of merger transactions involving a large number of undertakings active in a number of Member States, or even across the entire Community, more calculations of combinations of turnover will be needed than before to determine if a Community notification is necessary. This is not an easy task, requiring a detailed breakdown of the parties' Community turnover on a state by state basis in accordance with the Regulation's provisions. This could serve to increase the legal and other administrative costs for a large number of merger transactions which eventually will not meet the notification threshold, but which will still be subject to the extra costs and legal uncertainty of national merger control regimes. These calculations of turnover on a state by state basis, compared with the previous world and Community-wide figures also leave a potentially greater margin for error in establishing the competent authority.

Any future reform will probably require further lowering of the thresholds, further attention to the matter of the 'two-thirds' rule, and perhaps improved consistency of approach at a national level if the demands of industry for a true 'one stop shop' are to be met, and costs for all involved are to be minimised. US Federal Antitrust law has been a major force in the development of Competition law at a Community level, particularly in procedures for assessing the concentrative effects of mergers. Perhaps there is something to be learnt from the US Federal authorities' approach to regulation of mergers, which differs in some key areas.

[33] Statistics European Merger Control – Council Regulation 4064/89, European Commission

4. MERGER REGULATION IN THE U.S.A.

Mergers in the U.S.A. are deemed anti-competitive if they fall within the strict prohibition imposed by § 7 of the Clayton Act. This makes mergers which "may…substantially…lessen competition, or tend to create a monopoly" illegal. There is some overlap with the prohibition on attempts to monopolise, given by § 2 of the Sherman Act, but it is generally agreed now that the standards for testing mergers are the same under both provisions.

4.1 Notification and Initial Analysis

As a consequence of the potentially anti-competitive effects of mergers, there are statutory provisions in place in order to allow the competent authorities, the Federal Trade Commission (FTC) and the Antitrust Division of the Department of Justice (DOJ), to properly investigate any mergers of significance. Since the passing of the Hart-Scott-Rodino Antitrust Improvements Act in the late 1970's, now contained in § 7A of the Clayton Act, there is a requirement upon the parties to the merger agreement to notify the FTC in such a form to facilitate proper investigation by the antitrust authorities.

There is a requirement of notification if the acquirer in the transaction has capital in excess of US$ 100 million, the acquired person has assets to the value of US$ 10 million, and the transaction results in the acquirer having 15% or more of the voting securities and assets of the acquired person, or an aggregate total amount of the assets of the acquired person in excess of US$ 15 million. These requirements are significantly lower than those in the Community and consequently more transactions are caught by the provision. Companies are obliged to file in any significant merger, but even if the agreement falls below the limits it does not necessarily mean that it is acceptable to the US authorities. It is thus important for those acquiring securities to be aware of the need to notify if over these limits, both within and without the U.S.A., to avoid the harsh penalties possible under the system. It is not unusual for fines for non-notification to reach US$ 1 million[34].

Once notified, the file is passed to an inter-agency committee of DOJ and FTC staff, who decide which authority will conduct the investigation. This decision will normally come down to experience in the area, but it can be tempered by political influence. The investigating authority will rarely bring an action before a merger takes place. It can though seek a temporary restraining order in order to prevent the move in the short term. Again, this is a particularly undesirable outcome for the firms concerned, as the delay can bring enormous costs.

4.2 The Operation of the 1992 Horizontal Merger Guidelines

In order to clarify their position on mergers, the authorities jointly issued a set of merger Guidelines in 1992[35]. These give an outline of their enforcement policies regarding horizontal mergers. It is important to note however, that the enforcement of merger law in the US courts is still dependent exclusively on statute and case law, as these Guidelines are not binding on the courts. The courts have often looked to them as a reference, and have indeed used them as a template to weigh up the authorities' claims. Many have questioned the logic of the publication of these Guidelines, as they would appear at first sight to be counter-productive. One widely supported argument is that by creating these Guidelines, the Federal Government effectively limited itself in the number of cases it could bring, aiding corporations, who it should not be forgotten, are prone to making contributions to the costly process of election campaigns. The suggestion is that this meant that short-term political considerations were not compromised, but at a cost of compromising long-standing economic policy objectives.

[34] In *US v. Mahle GmbH* (1998) the District of Columbia Federal Court made the fifth fine over US$ 1 million, against a German undertaking which obtained voting capital in a US corporation, and failed to notify the FTC. It became liable through the operations of its US subsidiaries, and was fined $5 million

[35] 1992 Horizontal Merger Guidelines, 57 Fed. Reg. 41552 (Sep. 10, 1992). They replace in part the previous set of Guidelines issued by the DOJ in 1984

The official position is that the Guidelines are an attempt to rationalise, and to a limited extent codify the vast area of case law in existence, although their effectiveness in so doing has often been questioned. They are based on a fundamental principle that mergers should not be 'permitted to create or enhance market power or to facilitate its exercise[36]. The authorities state that in assessing whether a merger is anti-competitive or not, they go through a number of analytical steps. Most importantly, an assessment must be made as to whether the merger would create, or substantially increase market concentration. If it is thought this will not occur, then the authorities state that the merger is unlikely to create or enhance market power, and as a result does not merit further attention.

4.2.1 Analysis of the Relevant Market

The first step in establishing whether the merger will have the effect of increasing market concentration is to define exactly the market in question. For a merger to be deemed 'horizontal', both pre-merger firms must trade in the same relevant product and geographic market. The Guidelines define a relevant product market as a "a grouping of products such that a…firm that was the only present and future seller of those products…could profitably impose a 'small but significant and nontransitory' increase in price" (or SSNIP). The relevant geographic market is defined along the same lines.

In determining a relevant market the authorities will begin with the output of one of the merging undertakings and its closest competitors, and ask how many consumers would substitute away, or how many firms would enter the market in response to a SSNIP, a figure which is usually taken as 5%. If a large number of customers would substitute away or if a large number of suppliers of similar products, or of the same product in a different area could flood the market with substitutes in response to this price increase, the authorities will include these alternatives in the relevant market. They will repeat this process until they have identified a grouping of sales for which the elasticities of supply and demand are sufficiently low that the price increase would be profitable.

[36] Horizontal Merger Guidelines 1992, page 4

There are important questions here regarding differentiated markets. These are where there are a large number of firms producing homogenous products, and in these instances there may often be intensely localised competition. As a result the value taken by the authorities for the SSNIP in their assessment might actually be too high, the real figure being much smaller. Consequently the relevant market defined by the assessment process might very well be drawn too broadly, creating the possibility that mergers with potentially anti-competitive effects might occur. The authorities do note though, that they will be less likely to challenge mergers in markets for differentiated products.

4.2.2 Analysis of Market Concentration: The Herfindahl-Hirschman Index

If the parties to the merger are included in the relevant market thus defined, the agreement is deemed 'horizontal'. Once the relevant market is defined, at the smallest possible level, giving the smallest number of competitors, it must then be established whether the market would become concentrated if the merger were to occur. This is measured by means of the of the Herfindahl-Hirschman Index (HHI), which is calculated on the basis of the sum of the squares of the market shares of all the firms competing in the relevant market[37]. If the value produced for the post-merger HHI is below 1000 then the market is viewed as unconcentrated and the authorities are 'unlikely' to challenge the merger. If the post-merger HHI is between 1000 and 1800, it is viewed as moderately concentrated, and the authorities will probably not challenge a merger that produces an increase from the pre-merger HHI value of less than 100 points. If the increase is greater than this then they may challenge the merger depending on the presence of non-market share factors[38]. If the post-merger value is in excess of 1800, the market is regarded as highly concentrated, and the authorities will challenge most transactions that result in an HHI increase of more than 50 points. If the increase is more than 100 points then there is a presumption that the merger is

[37] The authorities will generally include the excess capacity of other firms in the market in their computation of market concentration

[38] See further below

likely to create or enhance market power or facilitate its exercise. Although not explicitly referred to in any legislation, this method is also employed by the MTF.

4.2.3 Non-Market Share Factors

The assessment of the legality of a merger by the authorities, and the courts, also takes into account a number of factors other than market shares. According to the Guidelines, if barriers to entry are so low that no firm in the market could profitably raise price to monopoly levels, then the authorities are unlikely to challenge the merger. This position has come back to haunt the authorities in *Waste Management* where the courts ruled that low barriers to entry were a reason for not condemning a merger, which was otherwise *prima facie* illegal and had been challenged by the authorities[39]. However, the courts have cited high barriers as a reason for condemning mergers far more often than they have approved mergers as a result of low barriers. The Guidelines analyze entry barriers under a three-part test that finds low entry barriers only if entry is shown to be likely, timely and sufficient to counter potential collusive pricing.

The authorities will also consider arguments of efficiency insofar as the parties could not attain them by any other means. The guidelines include a but/for test - in the absence of the merger, would either of the transacting parties be likely to fail and their assets be lost to the market?

One issue ignored by the Guidelines, presumably to allow a more flexible approach, is the significance of a trend towards concentration in individual markets. The 1960's saw the landmark Supreme Court decisions of *Brown Shoe*[40] and *Von's Grocery*[41] in this area. If the Court approved these mergers, it reasoned, it would be forced to approve other similar mergers in the future. The courts have relied upon this 'domino theory' in the intervening period to condemn numerous mergers. In these cases the trend

[39] *United States v. Waste Management, Inc.*, 743 F. 2d 976 (2nd Cir. 1984)
[40] *Brown Shoe Co. v. United States*, 82 S. Ct. 1502, 1535 (1962)
[41] *United States v. Von's Grocery Co.*, 86 S. Ct. 1478, 1482 (1966)

towards concentration existed because larger firms could take advantage of economies of scale, and as a consequence, the wisdom of the rule has been questioned. The reasoning behind the rule is often viewed as flawed. Its original application was with a view to avoiding concentration in the retail sector, principally to prevent “a supermarket culture”, in order to protect very small businesses[42]. It is not unreasonable to suggest that the trend toward concentration in the context the court cited should have been used to support rather than condemn the mergers, if the rationale was to protect the interests of the small business holders[43]. Even so, it is unlikely that this argument could be advanced as a reason to prevent large-scale mergers in the present climate, given its original application, and policy basis.

4.3 Enforcement by Other Persons

It is also possible for private individuals to bring legal action to enforce antitrust law in this area. Given the possibility of high levels of damages, and the option to proceed on a ‘class action’ basis, with split costs, or contingency fees, one would imagine this to be a frequently used means of enforcement, taking some of the strain off the authorities. The legislative history of the Sherman Act would suggest that the provision for private lawsuits in antitrust law was designed to facilitate competitor suits. Opinion at the time was that consumer litigants would be doomed to failure. There have been relatively few successful private actions in this field. It is also possible for States to bring actions, and indeed many have their own systems of Antitrust and merger law, but there is little consistency in policy and approach.

4.4 Comparisons with European Regulatory System

If the authorities chose to challenge the merger before the courts, the guidelines are used as a template to weigh up the Government’s claims, which the courts make an initial presumption against. The position is

[42] *supra* 86 S. Ct. at 1488.
[43] Perhaps ironically this rule often damages the small businesses it is designed to protect. If multi-store businesses are seeking to procure further stores, and cannot acquire pre-existing ones, they will simply build their own. The smaller shop

similar to the European system, insofar as the courts may if they see fit, like the Commission, order changes in the agreement, or even prevent it from occurring. One of the most important differences from the European system is that the courts may, for any transgression of Federal Antitrust law, including failures to notify the authorities within the period required, impose criminal penalties. This is to be contrasted with European law, which specifically states that the fines the Commission is empowered to levy, however substantial they may be, are definitely not "of a criminal law nature"[44].

The EC Regulation still covers vertical mergers within its regulatory structure, perhaps in contrast with the American system. Despite their economic expediency, in the past the US authorities have come down hard on them. This could possibly be due to the long-standing protectionist approach of the authorities and the courts towards small business, which was traditionally seen as more important in the assessment than any potential efficiency savings on the part of larger operators[45]. However the recent trend in US judicial thinking in this area has swung the other way. The US courts' current interpretation of the law has erred towards tolerating vertical mergers on the grounds of their efficiency savings, but one of their major concerns remains the potential effect of such transactions on smaller firms. The courts also remain preoccupied with not allowing vertical integration by merger to be a means of creating artificial barriers to market entry.

The overall result is a general US judicial attitude that vertical mergers should only be condemned in the most extreme of circumstances. Common academic opinion is that the tests of market power contained in the Guidelines are applicable to vertical mergers. However the fact that they are not covered in the Guidelines, and since the previous publication on merger regulation, in 1984[46], enforcement by the US

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proprietors will have to compete with the more effective operations of the larger organisations, and will be left with no easy means of exiting the market when things eventually go bad

[44] Article 14(4) AMR

[45] See *Brown Shoe Co. v. United States, supra*. One of the grounds for condemning the merger was that the cost savings to the acquiring firm, would be such as to allow it to undercut its competitors who had not undergone integration

[46] 49 Fed. Reg. 26,823 (1984)

authorities has all but stopped, would tend to suggest that vertical mergers are no longer viewed as dangerously anti-competitive[47].

4.5 Back to Where They Started?

The Guidelines focus is on preventing increased concentration in markets, with a view to avoiding tighter oligopolies and monopolies. An example of this policy is the extension of the scope of the notification rules to include limited liability companies, which were formerly not subject to the same provisions as corporations. This demonstrates the fact that the desire is still present amongst the US authorities to prevent as many anti-competitive mergers as possible, whatever the market or the nature of the companies involved. The question of how political concerns will hamper effective merger regulation in future does remain. It would seem that to a certain extent that one of most long-standing principles of Antitrust law, that of the preservation of the role of small scale enterprise as competitors within the marketplace, has been eroded by the political expediency of keeping larger corporations happy.

Ironically the industrial giant that many cite as one of the reasons the US, and as an indirect result Europe, came to have a system of Competition law in the first place, the Standard Oil Company, has now returned almost to the same form as it had in the late years of the nineteenth century[48]. In its present form, the Amoco corporation has continued to expand, merging with British Petroleum. So saying, in its current merger with its competitor Arco, it has won the praise of the Federal regulators for its constructive approach.

[47] Perhaps this argument is further evidenced by the fact that the 1984 Merger Guidelines refer only to 'horizontal' and 'non-horizontal' mergers

[48] History would suggest that Senator Sherman may have been acting at the behest of independent oil producers in his state of Ohio, who wanted protection from the strong bargaining positions in contractual negotiations held by Standard Oil and the Railroad companies

5. TOWARDS SUPRA-NATIONAL MERGER ENFORCEMENT?

The growth of the role of mergers in the global economy presents problems for regulatory agencies. Press coverage at the time of the Seattle World Trade Organisation summit last year noted that the forces shaping the planet now, are not national governments, but the likes of Microsoft and Monsanto, multinational corporations whose decisions influence, and seem likely to continue to influence every aspect of our everyday lives. Governments have proven to be all but powerless to control the actions of these corporations, whose power and wealth outstrip that of a large number of nation states. An example of this trend in the UK is the lack of Governmental interference in the genetically modified foods industry, despite what seems to be overwhelming public opposition. In the U.S.A. this is perhaps illustrated by the apparent casual disregard Microsoft holds for established principles of Federal antitrust law. Some have argued that the European Union is strong enough to act to regulate the actions of multi-national corporations effectively. It has though been unsuccessful in protecting the interests of its citizens in areas such as the WTO ruling preventing an import ban on hormone treated beef from the U.S.A.[49]. One wonders how the traditionally defined jurisdictions can seek to regulate changes in ownership of these corporations, with a view to protecting market competition, when they so clearly have little power over them in general.

5.1 International Arrangements in Place

Recent years have seen the US and European authorities recognise to a greater extent that merger regulation can be more effectively achieved by some degree of co-operation between their agencies. The root of this was in the frustration of the EU authorities with the fact that large international mergers were being investigated in many countries by the respective agencies, who were coming to often very different conclusions. After one such occasion in 1989, the then Commissioner responsible for Competition Policy, Sir Leon Brittan, announced that he was seeking a merger regulation treaty with the U.S.A. to

[49] The WTO itself has been roundly criticised for having more of an ear to the profit – maximising concerns of global corporations rather than the legitimate concerns of individuals of the effects on standards of living of its policies towards trade regulation

avoid these problems of conflicting approach in the future. The Federal authorities differed in their respective opinions towards the measure. The DOJ were strongly opposed, but the FTC were more receptive to the idea[50]. Although no US sovereignty over antitrust matters was ceded, agreement was reached, creating the US/EC Competition Co-operation Agreement[51].

One of the principal effects of the measure was to require notification by the authorities on either side of the Atlantic where their activities affected each other. It has also allowed the staff of the authorities to communicate with each other on activities of common interest. The possibility was also created, by means of an informal procedure, of joint notification of a merger that would potentially affect both jurisdictions, allowing the coordination of any investigation for greater efficiency. This procedure has now become semi-formal, although it presents businesses with the problem that it requires a waiver of their rights to confidentiality which are contained in the notification rules in each jurisdiction.

The authorities have seen the positive results of the measure, notably in the opportunities for better enforcement. There has also latterly been further agreement between the two on 'positive comity', meaning that each will recognise the other's decisions, and not act in contravention of them. The spirit of co-operation is further evidenced by the introduction of biannual meetings between the US and EU authorities.

The passing in the U.S.A. of the International Antitrust Enforcement Assistance Act (IAEAA) in 1994, is further testament to this trend of cooperation. With its basis in the pre-existing arrangements with Canada regarding the sharing of evidence in criminal investigations, it provides for the possibility of the creation of reciprocal agreements with the enforcement agencies of other nations. Under these the US authorities may assist in overseas investigations or even disclose Grand Jury evidence to the foreign

[50] Indeed the head of the DOJ Antitrust division, Joel Klein, has been consistent in speaking out against international agreements on enforcement

[51] The Agreement Between the Commission of the European Communities and the Government of the United States of America Regarding the Application of their Competition Laws 28/9/91. Certain EU Member States did not agree with the creation of such an agreement, and it was challenged before the courts. The matter was passed to the Council of Ministers and eventually ratified

agency. The US authorities may even establish a Grand Jury for use in the investigation of the overseas case.

It would seem that these measures stem from the recognition by competition authorities that over recent years, as international markets have become broader and increasingly deregulated, there is a need for more effective Competition law enforcement in order to preserve effective competition. Mergers frequently have enormous ramifications internationally. International investigations now account for 30% of antitrust activity by the US authorities, an astonishing figure given that 10 years ago, this figure was as low as 4%. As the US authorities face increasingly outwards, the proportion of antitrust defendants that are non-US citizens is now 50%, another dramatic increase[52].

5.2 Current Attitudes Towards International Merger Regulation

Recent developments suggest the current merger boom is a matter of some international concern. The WTO has stated that there is a need for uniform rules of antitrust enforcement. A United Nations treaty does exist on the matter but it is widely dismissed as being too powerless. An OECD committee has tried to obtain a certain degree of soft harmonisation in the areas of procedure and stronger cartel enforcement, but the outcome of these efforts has simply been to push US rules on the rest of the world[53].

Recent years have seen radical changes in market realities for industry. Traditionally profitable sectors of the economy are now being forced to consider dramatic measures to maintain profits, in order to keep investors happy. These shareholders are beginning to look elsewhere in the capital markets to receive better returns on their investments, notably towards new-tech corporations. Even corporations with a global market presence may be forced into finding means of maintaining investor interest in the near future. Mergers are simply one means of doing this, but their occurrence between corporations acting on

[52] One reason for this rise is the ever more aggressive enforcement of rules on notification in merger cases against overseas stockholders. The US courts have recently attacked foreign investors in antitrust generally, where their US holdings have become large enough to attract the attention of the US authorities

[53] This is not necessarily a bad thing, but it may simply result in resentment, and as a consequence, ineffective enforcement

this scale, again raises the question of how in the absence of formal international arrangements, their potential anti-competitive effects can be mitigated by effective enforcement?

5.3 Likelihood of Success?

Whilst there is a clear need for greater co-operation in the regulation merger cases internationally, one must be realistic as to the likelihood of success of any such measure. Disputes within the framework of the WTO in the past, particularly between the EU and the U.S.A., demonstrate the inescapable fact that international co – operation suffers, where national interests are in conflict[54]. It is certainly possible that a similar situation could arise in the field of mergers, if jurisdictions adopted different positions over a transaction, as a result of domestic political concerns.

[54] The area of state aid may see another such dispute in the coming months, over subsidies to the Airbus consortium

6. CONCLUSION

It would seem from this examination of the operations of the European and US authorities responsible for merger regulation, that the present situation is unsatisfactory, when viewed in terms of the objectives which these bodies strive to meet.

Both authorities are constrained by the provisions of the legal framework within which they operate. The MTF's capacity to act is limited by the restrictive turnover-based tests contained in the Merger Regulation, the effects of which are further compounded by the operation of the 'two-thirds' rule. The effects of the continued existence of these provisions in their present form are clear. They serve to exclude merger transactions of a size and nature that would have obvious anti-competitive effects on the Common Market. The provisions' restrictive effects also serve to effectively prevent the successful operation of the 'one stop shop' system, lobbied for by industry, thus denying greater legal certainty, and potential cost savings.

The American authorities have been limited more by a shift in economic and political attitudes, which has resulted in the publication of Guidelines that restrict their competence to act. On top of this their budgets have been cut in real terms by successive administrations.

An expansion of the spirit of co-operation that exists between the authorities is necessary if the challenges presented by changing global market conditions are to be adequately addressed. Globalisation and radical changes in market structure, towards the 'economic nationalism' envisaged by the Chicago School, may mean that the ability of existing jurisdictions to adequately ensure the maintenance of effective competition is compromised.

In general terms, a trend in enforcement can be seen to be developing. The MTF's capacity to act has been extended, and the next review of its powers may result in more of the same. The US approach to enforcement seems to be heading in the opposite direction, apart from in the area of extraterritorial action. Merger regulation by the US authorities remains more proactive than that by the MTF for the time being, but it would seem the future will see further forays into international co-operation by both. However, it is safe to conclude that these authorities are not adequately equipped to contend with current global market trends.

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