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Merger Clearance in the US and Europe: A Comparison

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Abstract

This paper argues that while objectives as well as procedures and institutions concerning merger decisions in the US and the EU differ, in practice merger decisions regarding companies operating in both jurisdictions are typically mirrored on each side of the Atlantic. The overruling by the European Commission of the GE-Honeywell merger, which had already been approved in the US, was an exception. We draw the following lessons for US firms seeking a merger involving the EU: 1) when preparing a merger proposal in the US, merging firms may be well advised to consult simultaneously with EU authorities to avoid unpleasant surprises in the future; 2) US firms may be advised to cooperate very closely with the Commission given the latter's substantial decision-making power. In contrast to merger decisions in the US, which uses an adversarial legal approach to merger decisions, the European Commission initiates, investigates and decides merger cases. Thus, the Federal Trade Commission and the Department of Justice may be subjected to more oversight than the European Commission. However, recent developments in the EU indicate that this difference may have become diminished. The annulment by the European Court of First Instance of the Commission's prohibition decision regarding the Schneider-Legrand and Tetra Laval-Sidel mergers could indicate that in the near future DG Competition will find it more difficult to say no; 3) US firms should be careful when lobbying in Brussels. The more aggressive lobby-style in the US comes across as less persuasive in Brussels.

I. INTRODUCTION

In July 2001, the European Commission struck a deadly blow to the proposed acquisition of Honeywell International Inc., an aerospace giant, by General Electric Co. (GE). The proposed $45 billion takeover of Honeywell was to be the world's largest industrial merger ever. Despite winning approval from the Federal Trade Commission (FTC) in the US, the European Commission ruled that a merged GE-Honeywell would be harmful to competition. Journalists and business analysts were quick to interpret the divergent conclusions by the EU and US authorities as an illustration that profound differences on this issue exist on each side of the Atlantic. This conclusion is premature. While there are clearly differences between US and EU objectives and procedures, in practice merger decisions regarding companies operating in both jurisdictions are typically mirrored on each side of the Atlantic.

We argue that while EU competition law is driven by the goal of unifying the European market and maintaining a level playing field for competitors, the US merger review focuses of the issue of consumer benefit. Nonetheless, empirical data from twelve years of merger reviews show that EU and US merger decisions are quite similar regardless of the different objectives and procedures. This article also shows that the EU and US consider similar economic issues when analyzing mergers. For instance, both examine the tradeoff between dominance and efficiency. The EU and US antitrust authorities share the belief that increased competition increases efficiency, and that these efficiencies in turn benefit consumers. The main difference is that in contrast to their US counterparts, EU authorities are more concerned about the danger of possible abuse of dominant position relative to potential consumer benefits.

The aim of this article is to elucidate audiences about differences between US and EU antitrust authorities in their objectives and procedures. Our main argument is that different procedures and institutional structures in certain (rare) cases may intensify divergent objectives of the EU and US merger authorities and override otherwise similar economic tests. Rather than perceiving European antitrust regulation as a "stumbling block on the road toward a more integrated global economy,"[1] a better understanding of both American and European antitrust principles will foster greater cooperation and reduce the risk of surprise merger decisions.

This article proceeds with a general discussion of European and American antitrust law, followed by an overview of the different objectives and procedures. We then discuss the economic objectives and tools used by each antitrust authority and how these methods affect their decisions. Although the GE-Honeywell case was an example of a vertical mergers between companies in dissimilar industries, our discussion focuses mainly on horizontal mergers between companies in similar industries. The latter are more typical. Finally, we review current issues and how they may encourage greater convergence between US and EU merger review in the future.

II. EUROPEAN COMPETITION LAW

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[1] David S. Evans. "The New Trustbusters: Brussels and Washington May Part Ways," *Foreign Affairs*, 81(1), 2002: 14.

European competition law is embodied in Articles 81-82 and Articles 87-89 of the European Community (EC) Treaty.[2] Articles 81 and 82 establish the most important competition rules in EU law. Article 81 prohibits concerted practices among firms to distort competition, unless these practices can be shown to have overriding benefits to the Community. Article 82 aims to prevent firms with a dominant position from practicing behavior that is detrimental to the interests of the common market. Articles 87-89 codify rules regarding member states' distribution of national subsidies, called "state aid," and do not pertain directly to mergers.

Although Articles 81 and 82 speak to collusion and market dominance, the 1957 Treaty specifies neither the rules nor the evaluation process regarding merger regulation. In fact, competition laws in general lacked strong enforcement until the momentum of European integration took hold in the late 1980s. The passage of the Single European Act in 1987 began the movement towards creating a single market in good, services, capital, and people by January 1, 1993. In 1989 the EU implemented the Merger Control Regulation, which today serves as the guideline for merger review. The 1989 Regulation also established the European Merger Task Force (MTF) as a separate unit within the Directorate General for Competition, whose role is to evaluate proposed mergers (called "concentrations" under EU law) and decide whether these actions are compatible with European competition.[3]

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[2] Originally called the European Economic Community (EEC) Treaty (1957), the EC Treaty was renamed by the Treaty of Maastricht in 1998, which also renumbered these Articles.

[3] Simon Bishop and Mike Walker. *The Economics or EC Competition Law: Concepts, Application and Measurement*. London: Sweet & Maxwell, 1999: 1-10.

The goals of European competition law are twofold.[4] The primary goal of all European law is market integration of the Community. Consequently, the Commission is especially harsh towards commercial behavior that it believes hinders cross-border trade within Europe. The second objective of European competition rules is sustaining competition within the Community. Article 81 and Article 82 and the European Merger Regulation include language focused on prohibiting firms from strengthening or creating a dominant position. Article 2 (3) of the Merger Control Regulation states that "A concentration which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market shall be declared incompatible with the common market."[5]

Many American scholars have emphasized the phrase "dominant power" in Article 82 to emphasize the ostensible difficulty in rendering a positive EU decision in cases of mergers between market leaders. However, the interpretation of competition law by Commission officials is not as loose as the reading by American observers. That is, European merger officials are more concerned with the *abuse* of dominance, rather than simply market dominance. The abuse of dominant position is defined by the disruption of competition, which is similar to US merger guidelines. "[T]he same economic principles are as valid in the application of E.C. competition law as in the application of competition law in other jurisdictions, including the United States."[6]

The European Merger Regulation gives the MTF, a division of the Directorate-General for Competition of the European Commission, the authority to review mergers,

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[4] Ibid, Chapter 1.
[5] Article 2 (3), Council Regulation (EEC) No. 4064/89 of December 1989 on the control of concentrations between undertakings.
[6] Simon Bishop and Mike Walker. *The Economics or EC Competition Law: Concepts, Application and Measurement*. Sweet & Maxwell, London, 1999: 5.

acquisitions, and proposed takeovers involving firms of significance to the common market. Specifically, mergers exceeding the following thresholds must be notified to the MTF within DG Competition: 1) parties with an aggregate worldwide turnover of more than €5 billion (approximately US$5 billion at the time of writing), 2) each of at least two of the parties with an aggregate EU-wide turnover of more than €250 billion (approximately US$250 billion at the time of writing), and 3) at least one party with more than two-thirds of its aggregate EU-wide turnover within one member state.

The MTF decision procedure is a two-stage process. Phase I involves the preliminary analysis of the merger, which must be completed in four weeks. In conducting its investigation, the MTF may draw upon the input of other offices within DG Competition and even other Directorates General for their industry expertise. The MTF also solicits comments from "all interested parties," including competitors and customers. The merger investigation begins by assessing whether the merger falls under the scope of regulation, whether the merger is compatible with the common market, and whether it strengthens a dominant position.[7]

After conducting its investigation, the MTF draws up a preliminary draft report, which is submitted to a so-called Advisory Committee on Concentrations. Once the Committee has reviewed the report and made its opinion, a draft decision is sent to the twenty members of the College of Commissioners at the Commission for decision. Decisions are then taken by simple majority voting (Article 8 in the Rules of Procedure for the Commission 8 December 2000). During Phase 1 the Commission may decide that 1) the merger is outside the scope of merger control, 2) it is compatible with competition,

[7] Michelle Cini and Lee McGowan. *Competition Policy in the European Union*. New York: St. Martin's Press, 1998: 121.

3) it is compatible with stipulated commitments, or 4) it should be referred to member states for judgment. Over 95% of mergers are settled through Phase I procedures.

Alternatively, the Commission may have doubts about the compatibility of the merger with the common market. In this situation, the Commission will proceed to a second, more detailed, investigation in Phase 2. Article 8 of the Merger Control Regulation specifies that the Commission must conduct the Phase 2 investigation within a four-month period. If a conditional or negative decision is likely to be reached, the Commission issues a formal Statement of Objections prior to the decision. This Statement presents the Commission's arguments against the merger and gives the merging parties two weeks to respond. At the end of Phase 2, the Commission's decision will be one of the following outcomes: 1) the concentration is cleared without conditions; 2) the concentration is approved if the merging companies meet certain conditions; or 3) the concentration is prohibited. All merger decisions must be made no later than five months after notification. The parties have a right to appeal all Commission decisions to the Court of First Instance.[8]

As the data in Figure 1 show, the European Commission approves most of the mergers, which it reviews. Since 1990, the Commission has rejected only eighteen proposed mergers, i.e., less than 1% of the notified cases. The prohibition of the merger between GE and Honeywell marked only the fifteenth time in eleven years that the European Commission had blocked a merger and only the second time that the European

[8]Alison Jones and Brenda Sufrin. *EC Competition Law. Text, Cases and Materials*. New York: Oxford University Press, 2001: 715

Commission has prohibited a merger involving at least one US company. The other such case was the proposed merger between MCI WorldCom and Sprint.[9]

Figure 1

European Merger Control Statistics

21 September 1990 to 31 October 2002

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Cumulative Total
Notifications														
Number of notified cases	12	63	60	58	95	110	131	172	235	292	345	335	215	2,123
Cases withdrawn, Phase 1	0	0	3	1	6	4	5	9	5	7	8	8	3	59
Cases withdrawn, Phase 2	0	0	0	1	0	0	1	0	4	5	6	4	0	21
Final Decisions														
Phase 1														
Out of Scope	2	5	9	4	5	9	6	4	6	1	1	1	0	53
Compatible	5	47	43	49	78	90	109	118	207	236	293	299	202	1,776
Compatible with commitments	0	3	4	0	2	3	0	2	12	19	28	13	8	94
Referral to Member States	0	0	1	1	1	0	3	7	4	4	6	7	9	43
Phase 2														
Referral to Member States	0	0	0	0	0	0	0	0	0	1	0	0	0	1
Compatible	0	1	1	1	2	2	1	1	3	0	3	5	2	22
Compatible with Commitments	0	3	3	2	2	3	3	7	4	8	12	10	4	61
Prohibition[1]	0	1	0	0	1	2	3	1	2	1	2	5	0	18
Restore Effective Competition	0	0	0	0	0	0	0	2	0	0	0	0	2	4
Total Final Decisions	**7**	**60**	**61**	**57**	**91**	**109**	**125**	**142**	**238**	**270**	**345**	**340**	**227**	**2,072**

[1]"Prohibition" is a rejection decision.

Source: Directorate General Competition, European Commission, http://europa.eu.int/comm/competition/mergers/cases/stats.html, 31 October 2002.

[9] Interview with Ms. Maria-Blanca Rodriguez-Galindo, representative from DG Competition, 4 November 2002.

Figure 1 also shows the explosive growth in the number of cases coming before the European Commission under merger control between 1996 and 2001. This marked increase coincides with the growing consolidation of businesses globally during this period. The decline over the past two years also reflects the slowdown in mergers caused in part by the slump in the global economy.

In summary, the data show that the Commission approves most mergers that are notified to the MTF. The year 2001 exhibited a peak of rejection decisions with five prohibited cases out of 227 total final decisions.

III. US ANTITRUST LAW

The following sections argue that EU competition law and US antitrust law are based on the same basic economic principles. However, this fact might seem almost serendipitous considering the different history that has produced these contrasting bodies of law. The US has a longer history of antitrust enforcement, beginning with the Sherman Act (1890), the Clayton Act (1914), and the Federal Trade Commission Act (1914). The Sherman Act forbids cartels (Section 1) and prohibits monopolies that engage in anticompetitive acts (Section 2). The Clayton Act prohibits all types of price discrimination (Section 2), the use of tie-ins (Section 3), and mergers (Section 7) that reduce competition, as well as interrelated directorates among competing firms (Section 8).[10]

Section 2 of the Sherman Act forms the basis of US rules regarding monopolistic conduct. Market power is assessed with respect to a specifically defined market. However, simply possessing size or market power alone is not illegal. The firm in

[10] Dennis W. Carlton and Jeffrey M. Perloff. *Modern Industrial Organization, Third Edition*. New York: Addison-Wesley, 2000: 602-3.

question must also have engaged in anticompetitive behavior. That is, some monopolies will avoid censure because their power is a consequence of their success in the market.

The Hart-Scott-Rodino Act of 1976 modified the merger review process in the United States. The Act stipulates that all large proposed mergers must be notified to both the Federal Trade Commission (FTC) and Antitrust Division of the Department of Justice (DoJ). Prior to the passage of Hart-Scott-Rodino, many horizontal merger cases were decided through the court system and many came before the US Supreme Court.

Once a proposed merger case is submitted for review, either the FTC or DoJ assumes responsibility for assessing its effects on market competition.[11] While both institutions have jurisdiction over merger review in most industries, each agency has developed expertise in specific industries. For instance, the FTC devotes itself to markets where consumer spending is high. Such markets include healthcare, food, energy, and high technology industries. The Justice Department has sole antitrust jurisdiction in cases subject to industry regulation by other agencies. Such instances include telecommunications, airlines, and rail.[12]

In 1992, The *Horizontal Merger Guidelines* of the DoJ and the FTC further defined the merger review process in the US. The Merger Guidelines outline the principles that the US government uses to analyze the effects of mergers on the market.[13] The size-of-transaction threshold is $50 million.[14] This contrasts with higher threshold in

[11] W. Kip Viscusi, John M. Vernon, and Joseph E. Harrington, Jr. *Economics of Regulation and Antitrust, Third Edition*. Cambridge MA: Massachusetts Institute of Technology, 2000: 208-9.
[12] Federal Trade Commission. "Promoting Competition, Protecting Consumers: A Plain English Guide to Antitrust Laws." www.ftc.gov/bc/compguide/index.htm.
[13] See Section 1.5 "Concentration and Market Shares", Horizontal Merger Guidelines, U.S. Department of Justice and the Federal Trade Commission, (www.usdoj.gov/atr/public/guidelines/horiz_book/15.html).
[14] According to the Federal Trade Commission Hart-Scott-Rodino Annual Report to Congress for Fiscal Year 2001, legislation in 2001 raised the threshold from $15 million to $50 million. (Section 630 of the

Europe, where the combined entity must be at least €250 billion in revenue (equaling $250 billion at the time of writing) or one of the parties must have at least €5 in revenue (equaling $5 billion at the time of writing).

Similar to the procedures at the European Commission, US agencies apply a two-step "premerger notification" process as outlined in the Hart-Scott-Rodino Act. After reporting the planned merger to the FTC and Antitrust Division of the DoJ, the parties wait for 30 days before they may complete the transaction.[15] If either agency determines that further inquiry is necessary, it may issue a "second request." The second request process mirrors the Phase 2 period of the merger investigation in the EU. During the second request, the waiting period for the merging parties is extended (typically to 30 more days). If the agency reviewing the merger believes that the proposed merger may substantially lessen competition, it may request an injunction in federal district court to prohibit the merger.[16]

The first step that the agencies undertake in reviewing a proposed merger is to define the relevant market. The *Merger Guidelines* identify a market to be the smallest group of products in the smallest geographical area such that a hypothetical monopoly could raise price by a certain amount above current or future levels.

The second step in the merger review process is to determine if the proposed merger will greatly increase concentration, and therefore, market power. The government typically employs the Herfindahl-Hirschman Index (HHI) to measure market

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Department of Commerce, Justice, and State, the Judiciary, and related Agencies Appropriations Act, FY 2001, Pub. L. No. 106-553, 114 Stat. 2762.

[15] The period is only 15 days in cases of cash tender offers of bankruptcy sales (Federal Trade Commission Hart-Scott-Rodino Annual Report to Congress for Fiscal Year 2001: 3, http://www.ftc.gov/bc/hsr/hsr.htm).

[16] Ibid, 3-4.

concentration. The Commission also uses the HHI technique to assess competitive effects of mergers and, like the US authorities, is not legally bound to do so. The HHI is the sum of the squared market shares of the players in the industry. A merger raises concerns when the HHI is over 1800 and the change in the HHI is over 50 points. If the HHI lies between 1000 and 1800, the merger does not raise concerns.[17] The HHI is used to distinguish mergers that do not raise competitive concerns from those mergers that may have adverse competitive effects and require further analysis.

The Merger Guidelines identify "market power" as a benchmark for analyzing mergers. Market power is defined as "the ability to raise prices above those that would be charged in a competitive market." Hence, the test is whether the merger would raise prices above competitive market price. The HHI does not provide information on price changes after mergers. Economists use measures of price elasticity to assess potential changes in price. Price elasticity is used to gauge whether the merging parties have so much market power such that consumers would become insensitive to price increases. Once a measure of price elasticity is found, it can be used to simulate post-merger price changes.[18] This type of econometric analysis is used frequently in the US and was applied in the review of the Staples-Office Depot and the L'Oréal-Maybelline mergers.[19]

The US agencies typically apply econometric analysis to merger review.[20] Indeed, in the adversarial legal system of the US agencies, each side will usually employ

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[17] Dennis W. Carlton and Jeffrey M. Perloff. *Modern Industrial Organization, Third Edition*. New York: Addison-Wesley, 2000: 613.
[18] See Chapter 9 of Carlton and Perloff for an overview of simulation techniques.
[19] Werden and Froeb at the Department of Justice have been influential in developing these techniques. See, G.J. Werden and L.M. Froeb. "Simulation as an Alternative to Structural Merger Policy in Differentiated Products Industries" in M.B. Coate and A.N. Kileit, eds. The Economics of the Antitrust Process. Boston: Kluwer, 1996.
[20] For a discussion of econometric techniques, see David Scheffman and Mary Coleman. "FTC Perspectives on the Use of Econometric Analyses in Antitrust Cases." www.ftc.org.

microeconomic arguments in their testimony. The role of economic analysis and econometric analysis is used less in EU merger review. Most of the staff at the MTF are legal experts rather than economists. We expect that the use of econometric analysis will increase at the Commission with the upcoming appointment of a lead economist by Commissioner Monti.[21]

The statutes governing US antitrust policy are written vaguely enough to invite debate among legal scholars on the objectives of antitrust law. The prevailing view is that the guiding principle of US antitrust law is to promote efficiency. Take the example of a merger that increases concentration in the market but allows the combined firm to produce at lower marginal costs. In this instance, it will most likely be viewed favorably as a merger that promotes efficiency, rather than one that reduces competition.[22]

Data in Figure 2 below show the breakdown of merger cases received by the FTC and DoJ. While data limitations prevent a direct comparison of prohibition decisions by the US agencies and the EU agencies, Figure 2 allows us to compare the number of cases that go on to a second request procedure, which is similar to the EU's Phase 2.[23] During 1992-2001, the percentage of merger reviews issued second requests ranged between 2.1% in 2000 to 4.1% in 1993. In contrast, mergers notified to the European Commission after 1990 enter Phase 2 more frequently. Data in Figure 1 show that the average percentage of cases entering Phase 2 during the September 1990 to October 2002 time period is approximately 5%.

[21] Mario Monti. "Europe's merger monitor." *The Economist*, 9 November 2002.
[22] Dennis W. Carlton and Jeffrey M. Perloff. *Modern Industrial Organization, Third Edition*. New York: Addison-Wesley, 2000: 613.
[23] Data concerning the total number of rejected cases by US agencies is not available.

Figure 2

United States Merger Review Statistics

1992 to 2001

	1992	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
Transactions Reported	1,589	1,846	2,305	2,816	3,087	3,702	4,728	4,642	4,926	2,376
Filings Received	3,030	3,559	4,403	5,439	6,001	7,199	9,264	9,151	9,941	4,800
Adjusted Transactions In Which A Second Request Could Have Been Issued	1,451	1,745	2,128	2,612	2,864	3,438	4,575	4,340	4,749	2,237
Investigations in Which Second Requests Were Issued	44	71	73	101	99	122	125	111	98	70
FTC	26	40	46	58	36	45	46	45	43	27
Percent	1.8%	2.3%	2.2%	2.2%	1.3%	1.3%	1.0%	1.0%	0.9%	1.2%
DOJ	18	31	27	43	63	77	79	68	55	43
Percent	1.2%	1.8%	1.3%	1.6%	2.2%	2.2%	1.7%	1.6%	1.2%	1.9%

Source: Federal Trade Commission Hart-Scott-Rodino Annual Report to Congress for Fiscal Year 2001, Appendix A, (http://www.ftc.gov/bc/hsr/hsr.htm).

However, the perception of greater scrutiny emerging from a comparison of EU and US merger review data may simply be a result of the fewer cases that are investigated by the European Merger Task Force each year rather than different procedures or economic principles. Whereas in 2001, the US agencies received 4,800 filings, the European Commission received only 335 notified cases. With fewer cases in the pipeline, it is easier for the MTF to investigate a greater percentage of cases in a Phase 2 procedure. One must exercise caution in interpreting a simple comparison of US agencies and European MTF case decisions because the agencies do not review the same list of merger cases. Many mergers do not involve transatlantic companies and will only be reviewed by either the US agencies of European MTF.

IV. INSTITUTIONAL DIFFERENCES

Different institutional arrangements on each side of the Atlantic contribute to uncertainty in merger decisions. For instance, the Commission has also been criticized for its combined responsibilities of initiating, investigating, and deciding merger cases. Despite these criticisms of the extended role of the Commission in merger cases, the final arbiter of the decision is the European Court of Justice (ECJ).

The oversight of the ECJ has recently become more significant. Between June and October 2002 the Court of First Instance overruled three merger decisions by DG Competition. In June 2002, the Court overturned the Commission's decision to block the merger of Airtours and First Choice, two British travel agencies. Using strong language in its opinion, the Court found that the Commission had made its decision in "manifest error." In October 2002, the Court overturned the Commission's prohibition of the merger between Schneider and Legrand, two French electrical equipment makers, and the merger between Tetra Laval and Sidel, two packaging companies. In the Tetra-Sidel case, the Court found the Commission's economic analysis to be faulty. In unusually blunt language, the Court said, "The economic analysis [of the merger's anti-competitive effects] is based on insufficient evidence and some errors of assessment."[24]

In contrast to the EU, merger procedures in the US involve the judicial branch of the government from the time of notification. Prior to a hearing, settlement negotiations between firms and the lead agency make take place. These meetings are designed to alter the terms of the merger to reduce possible anticompetitive effects.[25] Parties argue their case before a judge in an oral hearing. The final decision lies with the Supreme Court.

[24] Francesco Guerrera, "Court scraps Monti veto of packaging merger," *Financial Times*, 25 October 2002.
[25] W. Kip Viscusi, John M. Vernon, and Joseph E. Harrington, Jr. *Economics of Regulation and Antitrust, Third Edition*. Cambridge MA: Massachusetts Institute of Technology, 2000: 209.

The FTC and DoJ determine which cases the Court will consider; however, it is unlikely that the agencies will bring cases to the Court which they believe they may lose.[26] A system of public testimony in the US system is viewed as a weakness because many third parties to the merging companies are not prepared to testify openly against their competitors, suppliers, or customers.[27]

Although lobbying is a standard activity at the Department of Justice and Federal Trade Commission, it is more taboo in Brussels where senior policy officials are more sensitive to accusations of biased decisions. In fact, some view GE's aggressive lobbying efforts in Brussels as detrimental to its merger proposal. Rather, EU competition officials place more importance on information from the rivals of the merging companies, relative to their American counterparts. Whereas complaints from competitors would be seen as good for competition by the US, the Europeans rely on this information due to resource constraints.[28]

Whereas Americans view Europeans as appealing to political interests by protecting inefficient home firms, some view US mergers as dependent, in part, on the political leanings of the President in power. For instance, the current Bush Administration is perceived to have appointed more pro big business staff to the FTC and DoJ than previous administrations.[29] In the past, both parties followed an unwritten rule against allowing an industry with three dominant players to shrink to a duopoly.

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[26] Ibid: 210.
[27] Edward Bannerman. "The future of EU competition policy," Center for European Reform, February 2002: 28–29.
[28] "Navigating Brussels: How Merger Regulation Works in the EU Capital," An American Lawyer Media Supplement, Winter 2002: 31.
[29] Dan Carney, "Bush's Trustbusters Need Another Name," *Business Week*, September 13, 2002.

However, the Bush Administration seems more willing to consider these mergers.[30] In addition, some Europeans allege that the partisanship of the American executive influences the outcome of US merger decisions. Specifically, the FTC and DoJ during Republican administrations are seen as being more in favor of big business than during Democratic administrations.[31] However, the contrary is not true. Having a Democrat as President does not guarantee that big business mergers will be rejected. For instance, the Boeing-McDonnell Douglas merger was approved during the Clinton administration. The EU also approved this merger after initial misgivings about its effect on competition.

V. SIMILAR ECONOMICS, DIFFERENT INTERPRETATIONS

The economics of competition policy in Europe and industrial economics, as it is known in the United States, are based on the notion that competition is good. Competition leads to cost efficiency, lower prices, and technological innovation. Competition markets produce greater consumer welfare.

The question for merger analysis becomes how do we recognize when a merger will infringe market competition? Although perfect competition is the basis of microeconomics, it is rarely observed in the real world. Likewise, few industries are characterized by a single monopolistic firm. Typically, merging companies operate in oligopolistic market conditions, and the process of merger review investigates whether

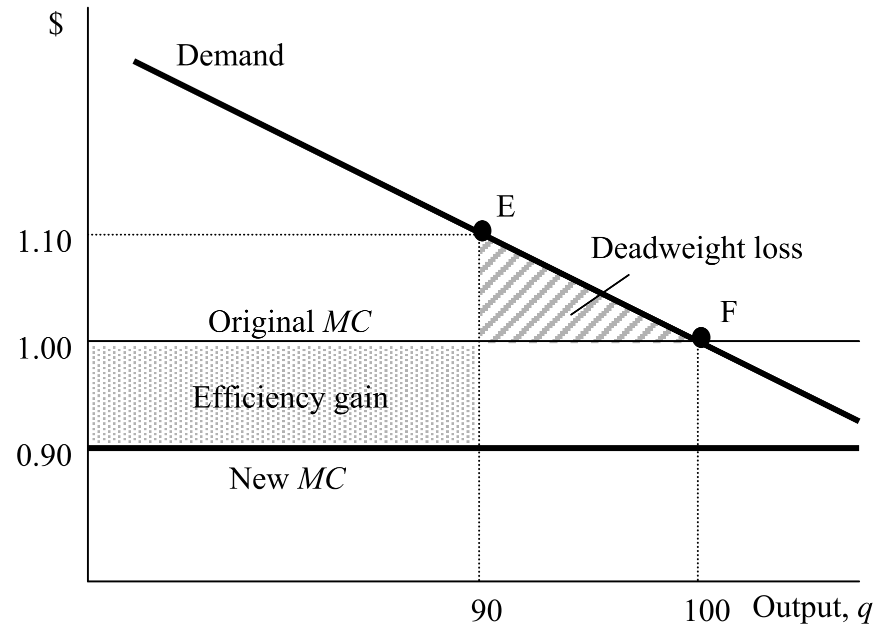
[30] The proposed Echostar-DirecTV merger between two satellite broadcasters is an example. This merger has since been rejected by the US Federal Communications Commission.
[31] Interview with Holger Dickmann, Directorate-General Competition, European Commission, 16 October 2000.

the merger will reduce effective competition and increase market power in the merged entity.[32]

Companies in similar industries typically merge in an effort to reduce costs, for instance, by increasing economies of scale. In a competitive market, the benefits of reducing a firm's costs would be passed on to the consumer through lower prices. However for some horizontal mergers, cost reductions, or "efficiency gains" can produce *higher* prices. Figure 2 below illustrates this scenario. The illustration shows a merger that produces an efficiency gain in lower production costs as well as a deadweight loss in higher prices and less production quantity. This model was first developed by Oliver Williamson to compare the social costs and benefits of mergers.[33]

[32] Simon Bishop and Mike Walker. *The Economics of EC Competition Law: Concepts, Applications and Measurement*. London: Sweet & Maxwell, 1999:11-45.
[33] Oliver E. Williamson, "Economies as an Antitrust Defense: The Welfare Tradeoffs," *American Economic Review*, March 1968.

Figure 3
Production Efficiency vs. Market Power Harm



Source: Carlton, Dennis W. and Perloff, Jeffrey M., *Modern Industrial Organization, Third Edition.* New York: Addison-Wesley, 2000, p. 605.

In the scenario in Figure 2, more efficient production resulting from the merger cause the average marginal cost of production between the two firms to fall from one dollar to 90 cents. The reduction of cost results in greater productive efficiency represented by the shaded rectangle in Figure 2. However, price increases cause a deadweight loss represented by the shaded triangle in Figure 2. Before the merger, competition forced the firms to price at marginal cost, point F in Figure 2. After the merger, market power is created, and price rises to point E. This illustration clearly shows how mergers can create a trade-off between efficiency gains and increased prices, resulting from the elimination of competition. Williamson argued that a merger is good for society if the triangular area, representing the deadweight loss from the price increase, is smaller than the rectangular area of efficiency gain. However, the relative size of these two areas is hard to measure and depends on particular circumstances.

The model in Figure 2 can be used to summarize the general differences between the approach of the US and EU in analyzing the effects of mergers. In general, the tendency in the US has been to focus more on efficiency gains, while in the EU, the tendency is to focus on the harmful effects of reduced competition. In Figure 2, these detrimental effects are price increases. While both the US and the EU try to calculate whether the efficiency gain outweighs the loss to competition, measures are typically based on inefficient data and can produce varying conclusions.

Some Europeans would argue that the US focuses too strongly on the efficiency gains.[34] The US argues that efficiency gains benefit the consumer. By emphasizing consumer benefit, US authorities follow the free market tenets of Chicago School economics. The Chicago School economists hold the view that mergers inherently weaken competitors and strengthen the merging companies. These gains to the merging

[34] Edward Bannerman. "The future of EU competition policy," Center for European Reform, February 2002: 26–27.

companies benefit society. As a consequence, the more efficient merged entity squeezes out other competitors, who naturally will complain of anticompetitive behavior.

In contrast, European authorities place more weight relative to their US counterparts on the views of competitors and suppliers in an effort to protect consumers' long-term interests. In this way, European merger control aims to ensure that markets remain sufficiently competitive in the long run, such that consumers may benefit from choice, innovation, and competitive prices. For instance, a more efficient concentration may, at first, pass on cost savings to customers by reducing prices and, in doing so, acquire dominant market power. The European concern is that the merged entity would then be able to abuse its market dominance by raising prices once relevant competition has been pushed out of the market. Increased prices could reach oligopolistic levels. While this concern has earned the EU criticism for putting the interests of competitors ahead of consumers, it is clear that in this scenario consumers are hurt in the long run. The link between competition and consumer benefit is aptly summarized by Mario Monti, the European Commissioner for Competition Policy:

> Somebody must check that a merger does not result in excessive market power and thus ensure that consumers will continue to benefit from a competitive environment in terms of innovation, quality, choice and prices (Mario Monti, <u>A Global Competition Policy?</u> European Competition Day, Copenhagen, 17 September 2002).

VI. DIFFERENT TESTS

In addition to this different perception of the potential for mergers to have anticompetitive effects, the US and EU differ on specific techniques used to analyze mergers. One such example is the debate between the use of the "dominance test" by the European authorities versus the "substantial lessening of competition" test by American authorities. The difference comes directly from the text governing each authority's antitrust laws. In the EU, where the law governing merger control was drafted in 1990, mergers must be declared unlawful where they "create or strengthen a dominant position." In the US, according to a statute from 1914, mergers are not allowed if they result in "a substantial lessening of competition" (speech by Mario Monti to the American Bar Association, 14 November 2001).

One critique of the dominance test currently used by the Commission is that it is "all or nothing." Either the merger would give the new entity market dominance or not. Under the substantial lessening evaluation, proposed mergers that might appear to lessen competition would have the opportunities to make a case for increased efficiencies resulting from the merger. Although some international attorneys propose that the EU also adopt the substantial lessening of competition (SLC) test to harmonize practices with the US, Commissioner Monti does not have immediate plans to adopt this reform (Speech at DG Competition/International Bar Association Conference on EU Merger Control, Brussels, 7-8 November 2002).

The debate between the use of SLC and dominance tests reflect differences in reviewing horizontal mergers. However, the EU and US antitrust authorities also diverge in some instances of vertical mergers. The most recent and well-publicized example is the GE-Honeywell merger.

The Commission believes that if a merger between companies of different industries gives the entity “portfolio power,” the deal may be harmful to competition. Portfolio power is the ability to bundle a broad range of related products. The bundling argument was first used in the EU’s scrutiny of the GE-Honeywell deal. The Commission claimed that GE could tie sales of aircraft engines and avionics from Honeywell into cut-price bundles that would drive out competitors. When GE attacked this line of argument, the Commission argued that GE-Honeywell would be too “influential” in the market for aircraft engines and systems. Consequently, the Commission called for the sale of parts of Honeywell’s avionics business as well as modifying the business of GE’s aircraft leasing division, GE-CAS.

Another example of the EU’s application of tying arguments includes the merger between Grand Metropolitan and Guinness to create Diageo Plc, the world’s largest liquor company. The EU believed that by bundling their broad range of drink products, from whiskey to champagne, the merged giant could put pressure on distributors to buy more of their products.

VII. SIMILAR OUTCOMES IN MERGER DECISIONS

Despite the publicity surrounding conflicting decisions in the US and Europe, in fact, differences are rare. As in other areas of commercial and trade policy, the US and EU confer extensively on issues related to antitrust and competition. According to Monti, "The EU and US see eye to eye on virtually all aspects of antitrust and merger policy."[35] Both sides have considered the idea of creating a global competition forum. Indeed, since the controversial Boeing-McDonnell Douglas decision in which the European Commission came close to opposing the merger, the US and EU regulatory authorities have initiated more transatlantic dialogue.

In 1991 the US and the EU concluded a cooperation agreement regarding merger policy. This agreement imposes obligations on American and European competition authorities to notify each other when its enforcement activities may impact the activities of the other. The US and EU also agreed to exchange information, to cooperate in the enforcement of each other's competition rules and to consider each other's important interests.[36] A working group has recently been established to evaluate differences and similarities between EU and US competition rules with representation from DG Competition, the Antitrust division of the US Department of Justice, and US Federal Trade Commission. On 30 October 2002 the EU and US competition authorities issued an overview of best practice guidelines by which both sides would abide. The main elements of this overview involve coordinating collection and evaluation of evidence. In addition, both sides would coordinate investigation timetables, increase communication

[35] Speech by Mario Monti to the American Bar Association, 14 November 2001.
[36] Alison Jones and Sufrin, Brenda. *EC Competition Law. Text, Cases and Materials*. New York: Oxford University Press, 2001.

between the respective agencies, and ensure consistency between contingency remedies for merger approval[37]

While disagreements between US and EU merger authorities remain few, conflicting decisions typically involve high-profile cases, thus receiving a lot of media attention. The GE-Honeywell case is only the second time that the Commission has vetoed the merger of only American companies. The first was the MCI WorldCom-Sprint merger. According to the Commission, a merger between MCI WorldCom and Sprint would have resulted in the creation of a dominant position in the market for top-level universal Internet connectivity. The companies proposed to divest Sprint's Internet business but this was considered insufficient by the Commission to resolve competition concerns.[38] It is no coincidence that US competition authorities also did not approve the merger. The Department of Justice found that competition would suffer if it allowed a move from three major long distance telecommunications firms to two.[39]

The perception that EU merger authorities always take a more negative position than US counterparts is incorrect. Indeed, the US has blocked mergers that had been approved by the European Commission. In 2000, the US blocked the takeover of BOC by Air Liquide/Air Products, despite EU approval.

VII. CURRENT EUROPEAN REFORMS

Commissioner Monti has recently announced reforms of the European antitrust procedures which aim to increase transparency and consistency as well as improve the

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[37] Commission Press Room, "EU and US issue best practices concerning bilateral cooperation in merger cases," 30 October 2002.
[38] European Commission, "Commission prohibits merger between MCI WorldCom and Sprint," press release, 28 June 2000.
[39] *The Economist*, "Disconnected," June 29 2000.

decision making process of merger review. He has called for the appointment of a chief economist who would be seconded to the Commission to give leadership to the review process. This person would be abreast of the latest economic thinking in the field of industrial organization. In addition, he has proposed a systematic peer review panel which would be independent from the Merger Task Force. The panel would review the analysis at key points during the investigation of the merger review. As an independent panel, this new body would add "checks" to the current merger review procedure.[40]

VIII. CONCLUSIONS

This paper argues that while objectives as well as procedures and institutions concerning merger decisions in the US and the EU differ, in practice merger decisions regarding companies operating in both jurisdictions are typically the same. A highly publicized exception was the European Commission's overruling of the GE-Honeywell merger which had already been approved in the US.

We draw the following lessons for US firms seeking a merger involving the EU:

1. *When preparing a merger proposal in the US, merging firms may be well advised to consult simultaneously with EU authorities to avoid unpleasant surprises in the future.*

2. *US firms may be advised to cooperate very closely with the Commission given the latter's substantial decision-making power.* In contrast to merger decisions in the US which uses a adversarial legal approach to merger decisions, the European Commission initiates,

[40] Mario Monti. "Europe's merger monitor." *The Economist*, 9 November 2002.

investigates and decides merger cases. Thus, the FTC and DoJ may be subjected to more oversight than the European Commission. However, recent developments in the EU indicate that this difference may have become diminished. The annulment by the European Court of First Instance of the Commission's prohibition decision regarding the Schneider-Legrand and Tetra Laval-Sidel mergers could indicate that in the near future DG Competition will find it more difficult to say no.

3. *US firms should be careful when lobbying in Brussels.* The more aggressive lobby-style in the US comes across as less persuasive in Brussels.

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