UNIT EC455, LEVEL 3

LECTURE: EC POLICY ON MERGERS

THE ECONOMICS OF EUROPEAN INDUSTRY

Semester 2

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Aims

- To explore the rationale for and impact of mergers with specific reference to Merger Control Regulation within the European Union.

Learning Outcomes

Students will be able to

- analyse the recent trends in EU mergers and examine recent case studies.
- analyse the institutional framework regarding European merger control.
- critically examine the costs and benefits of mergers.
- critically consider the importance of transferring legislative power to the European level.

Further Activity

- Test yourself on the above objectives.
- Write a 250 word piece on the rationale for and impact of mergers in the EC over the past decade.

Notes: Competition Policy in the EU with specific reference to merger control

Data

Much of the data is self-explanatory but I shall comment on trends and sectoral issues.

TABLE 1: Evolution of M&A involving EU firms

Year	Number	% change
1991	8236	
1992	8000	–2.9%
1993	7327	–8.4%
1994	8006	9.3%
1995	8777	9.6%
1996	8087	–7.9%
1997	8382	3.6%
1998	10024	19.6%
1999	12796	27.7%

TABLE 2: **Distribution of M&A activity and GDP between Member States, 1991–1999**

Member State	Share of M&A activity (%)	Share of GDP (%)
B	2.80	3.2
DK	2.54	2.1
D	16.54	28.4
EL	0.67	1.4
E	4.84	6.9
F	14.38	18.1
IRL	1.58	0.8
I	6.39	12.7
L	0.47	0.2
NL	6.90	4.9
A	1.91	2.7
P	1.06	1.3
FIN	4.15	1.6
S	5.34	2.8
UK	30.45	13.0
EU	100	100

Note: In caculating this table, cross–border intra–Community operations are counted twice, once for the bidder country and once for the target country.

TABLE 3 Evolution of National, Community and International M&A operations

Year	National	Community	Int EU–target	Int EU–bidder	Total
1991	65.1%	14.0%	12.8%	8.1%	100.0%
1992	67.9%	12.9%	12.2%	7.1%	100.0%
1993	63.5%	12.5%	14.9%	9.1%	100.0%
1994	62.7%	13.6%	13.5%	10.2%	100.0%
1995	61.0%	13.5%	12.7%	12.7%	100.0%
1996	57.9%	13.5%	14.8%	13.8%	100.0%
1997	56.8%	14.3%	15.6%	13.3%	100.0%
1998	55.0%	14.5%	15.5%	14.9%	100.0%
1999	56.5%	15.0%	11.2%	17.4%	100.0%

What factors are affecting these trends?

There are a number of factors that could explain what has been happening over time to mergers and acquisitions. The European Commission economists have tested number of factors.

First, it may be related to long term real interest rates because it is cheaper to borrow when interest rates are falling. It may also be that merger activity increases because large rises in the average price earnings ratio (PER) is likely to be accompanied by a substantial increase in the variation in PER between individual firms. The result is that firms with a high PER may find it attractive to acquire the undervalued firm by means of a 'share swap'. Similarly, cross border variations in PERs may have an affect on acquisitions in that lower relative levels of PER in a country would be associated with a larger number of firms being targeted by overseas companies. There have also been studies showing a correlation between share prices and mergers in the UK and USA over time and so the EC economists tested this hypothesis too. In all cases they found no support for the change in merger activity over time.

An interesting issue is whether monetary union is having an effect on merger and acquisition activity. The single currency may have two affects. First, it can be expected to lead to higher levels of integration of product and service markets in general to take account of opportunities to reap economies of scale or defend domestic markets against increased cross border competition. Second, the greater integration of financial markets may make it easier for firms situated in the euro-zone to raise the capital needed to acquire overseas companies.

If the first effect is significant, it should reveal itself in a comparison between operations targeting the euro-zone and those targeting Member States not currently in the Euro-zone. These integration effects were seen in the run up to the Single Market. However, the growth rate of operations targeting firms in the Euro-zone only exceeded that of operations targeting other Member States for the first time since 1995. So the evidence is rather limited.

The effect of finance should manifest itself in an increase in the number of acquisitions by Euro-Zone firms relative to that of other EU firms. Whilst this is true there is only one years evidence to this effect.

Table 4 **Sectoral breakdown of cross–border M&A operations with an EU target, 1998–1999**

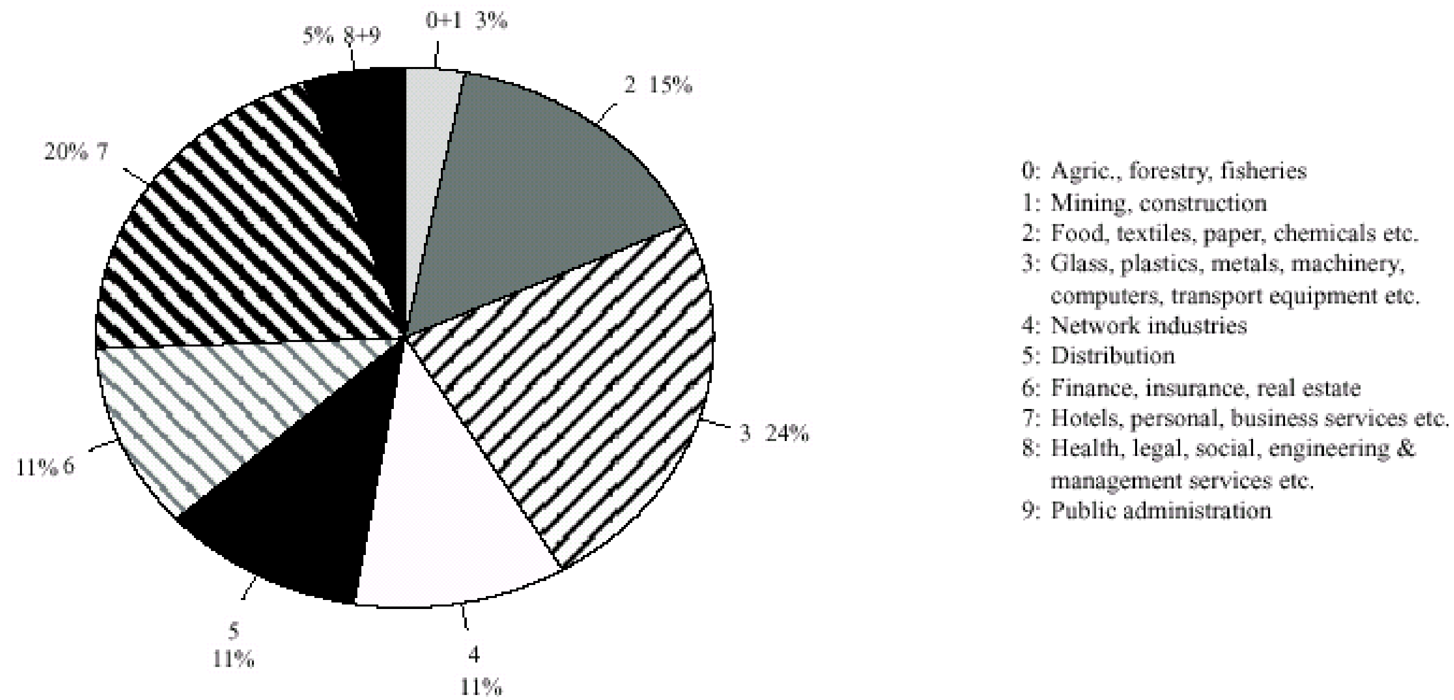


Table 5 : Most targeted sectors in M&A operations where the target is a Community enterprise, in percent of total – 1996–1999

Sector	SIC 2	% total 1998–99	% total 1996–97
Business Services	73	14.66	9.10
Real estate	65	5.80	3.24
Wholesale – durable goods	50	4.39	4.85
Industrial machinery & equipment, including computers	35	4.07	4.95
Food and kindred products	20	3.74	4.58
Engineering and management services	87	3.73	3.51
Printing & publishing	27	3.42	3.98
Chemicals and allied products	28	3.40	4.24
Electronic and other electrical equipment	36	3.19	3.42
Communication	48	3.03	3.01
Holding and other investment offices	67	2.80	4.30
Wholesale – non–durable goods	51	2.77	2.69
Banking (depository institutions)	60	2.10	2.33
Electric, gas and sanitary services	49	2.09	2.00
Fabricated metal products	34	2.03	2.19
Transport equipment	37	1.94	2.14
Transportation services	47	1.59	1.50
Instruments and related products	38	1.57	2.21
Hotels and other lodging places	70	1.57	1.54
Insurance carriers	63	1.49	2.35

Table 6 Types of merger by target sectors (target EU, cross–border + national) 1996–September 1998

Targeted sector	SIC 4	Horizontal	Vertical upstream	Vertical downstream	Conglo-merate
Wood, building materials	6130	46.4%	22.4%	3.2%	28.0%
Motor vehicles/parts	6148	43.8%	17.5%	8.8%	30.0%
Textiles	6160	40.9%	27.3%	4.5%	27.3%
Agricultural	6110	38.5%	11.5%	3.8%	46.2%
Machinery/Industrial Equipment	6149	37.7%	23.2%	1.6%	37.5%
Food & drink	6170	37.1%	26.3%	8.9%	27.7%
Others	6190	32.9%	–	–	–
Households goods	6150	29.9%	19.7%	6.8%	43.6%
Pharmaceutical	6180	29.8%	35.1%	1.8%	33.3%
Fuels, ores, …	6120	25.8%	33.5%	1.9%	38.7%

TABLE 6 : Types of merger by target sectors (target EU, cross–border + national) 1996– September 1998

Targeted sector	SIC 4	Horizontal	Vertical int.	Conglo–merate
Legal services	8350	97.6%	–	2.4%
Accountants, auditors, tax experts	8360	82.2%	8.9%	8.9%
Advertising	8380	73.9%	2.9%	23.2%
Computer services	8394	61.1%	10.4%	28.5%
House and estates agents	8340	61.1%	8.3%	30.6%
Business services – others	8395	56.0%	–	–
Professional & technical services – others	8370	55.1%	–	–
Insurance – auxiliary activities	8320	44.0%	48.0%	8.0%
Holding companies	8396	–	–	–
Banking & finances – auxiliary activities	8310	30.8%	50.0%	19.2%

Source of Data: European Economy – Supplement A. Economic Trends available at http://europa.eu.int/comm/economy_finance/document/docum_en.htm **or more specifically at** http://europa.eu.int/comm/economy_finance/document/eesuppa/a1999_02_en.pdf

Sectoral distribution of cases

Reflecting the general trend of Merger and Acquisition activity, industry accounts for a steadily declining proportion of cases dealt with under the Regulation. In the period 1991–1993, industry's share was 61%, while in 1996–1998 it was only 52%. Almost all of the remainder related to service sectors, the number of cases in the construction sector being very small.

Because the Merger Regulation applies only to operations involving firms with a very high turnover, notifiable operations are heavily concentrated in sectors where the average size of firms is large, such as chemicals, electrical equipment, telecommunications, banking and insurance. Hence we find, for example, that the chemical industry accounts for 10% of Merger Regulation cases compared to only 4% of operations recorded by AMDATA, the source of EC statistics. The disparity is even more striking in the post and telecommunications and insurance sectors. Comparing the first three full years of implementation of the Merger Regulation with the last three years, we find that the relative importance of the chemical industry has remained steady at 10% of all cases. The food industry, on the other hand, now accounts for a much smaller proportion of cases than in the early days of the Regulation, having declined from 9.7% to 3.2%. The shares of cases in the electrical and optical equipment and motor vehicles sectors have also fallen substantially.

Privatisation and liberalisation in the network industries have led to a large increase in the number of cases in the electricity, gas, post and telecommunications sectors. In the first two sectors, there were no cases in 1991–1993 but 13 cases in 1996–1998 (2.6% of the total). In post and telecommunications, the number of cases rose from 5 in 1991–1993 (2.9% of the total) to 44 in the last three years (8.8% of the total). In the other service sectors, the share of banking has fallen from 8.6% to 7%, while that of insurance has remained stable at about 6%. Surprisingly, given the increase in the overall level of M&A activity in this sector, the number of cases in the business services sector was no greater in 1996–1998 than in the earlier period: 8 cases in both periods. As a proportion of the total, business services fell from 4.6% to 1.6%.

Sectoral Issues

The data clearly show that the biggest growth area in mergers and acquisitions is that of Business Services. To consider whether a merger has any competition effects the principle sectors of activity of the firms concerned can be examined. Thus, mergers can be grouped as follows

Horizontal - mergers between firms in the same four digit sub sector.

Vertical – mergers between firms in sub-sectors that are linked by an important supply relationship (e.g. wholesale and retail food and drink)

Conglomerate – mergers between firms in different sub-sectors with no evident vertical link (i.e. they are largely about diversification).

In the above tables we can see that in those growth sectors where some distinction is possible we can see that horizontal integration is more likely. However, vertical integration, particularly upstream vertical integration is more relevant in sector 83.

Motives for Merger

Market Power. All types of Merger can increase market power and I will say more in a moment. Horizontal mergers lead to fewer firms in the industry and raise the concentration ratio. In essence we know from our study of the welfare effects of oligopoly that a reduction in the number of firms can lead to a reduction in welfare. Thus, horizontal mergers can be detrimental. Likewise vertical mergers can raise entry barriers, or facilitate collusion.

Efficiency. **Economies of scale** and synergy are often cited as a motive for horizontal merger. The **market for corporate control** affords good managers the opportunity to acquire companies that are underperforming (that is X-inefficiency is seen to exist). However, the Continental European market for corporate control facilitates merger rather than hostile takeovers because of the organisational make-up of the firms concerned. For this reason, mergers are often cited as a reason for improving **investment in technological capacity** over the long haul.

One of the classic reasons for vertical integration is **transaction costs** (see my notes on this from EC425). For example, suppliers may also acquire wholesale companies when they wish to enter a new geographic market but experience difficulty in establishing suitable distribution arrangements. In such circumstances, the acquisition of a wholesale company already established in the target market may be the best way to enter the market

Financial Motives. The argument here is that 'the whole is worth more than the sum of the parts'. Suppose a large conglomerate firm, XYZ, has a price/earnings ratio for its stock of 20, but a small target firm, ABC, has a much lower price/earnings ratio of 10. If the annual profits (earnings) of ABC are £10 million, then its current stock value is 10 x £10 million = £100 million. If the annual profits of XYZ are £500 million, its stock value is £10 billion. If XYZ acquires ABC its earnings rise to £510 million and its stock market value rises by £200 million to £10.2 billion. Suppose XYZ offers to pay £125 million for ABC. Both shareholders are better off.

Of course, this requires stock market myopia – that is, even in the absence of any real benefits the stock market believes the conglomerate will improve the performance of the acquired firm. The problem comes when a growing firm continues in this way. Eventually the firm's record of achievement will come under scrutiny.

Risk Reduction. Pure conglomerate mergers are the most likely to reduce risk because they indicate diversification into areas where interdependence between products is lowest.

Empire Building, Failing Firms and Aging Owners. Fairly self-explanatory.

EC policy developments and Globalisation

The development of the internal market programme since the passing of the Single European Act in 1986 has led to a re-positioning of firms in the EU. Globalisation and the creation of the Euro zone have hastened these developments in more recent times (see European Economy Supplement A, various editions). As a consequence there has been an increase in cross border acquisitions from within the EU and from overseas.

Indeed, European Economy shows that the motives for the mergers have changed since the mid-1980s:

- diversification, rationalisation and synergies are less important now than
- Expansion and the strengthening of market position.

Thus firms in the EU are carrying out strategic asset seeking. An EC study addressing efficiency gains and competition losses across the EU shows that there are still enormous efficiency gains to be made in (e.g. technologically dynamic) industries where reduction in competition from merger is slight. However, there are also mergers, acquisitions and joint ventures that the Commission should be wary of.

Welfare Effects

Theoretically mergers may be good they may be bad.

Horizontal Mergers

Some of the following is based on NERA (1999 p.18) available at the OFT website.

There are three concerns regarding Horizontal mergers. They have

- **Unilateral effects**. In effect they reduce the number of players in the market.

- **Co-ordinating Effects**. Here they may create an environment in which explicit or tacit collusion can develop.

- **Exclusionary Practices**. For example, it might be feared that the merged firm would be better placed to engage in predation, anti-competitive discriminatory pricing, conditional discounting, full-line forcing or refusal to supply. Fear of exclusionary practices can arguably be considered a variant on the first concern.

One of the most frequently heard defences of a merger which involves firms with apparently high market shares is that the market is actually wider than it may initially appear and that consequently the increase in concentration is far less than it might have seemed.

Market definition arguments aside, horizontal mergers that generate a significant increase in market concentration and consequently raise fears of unilateral or co-ordinated effects may be defended on two grounds.

- First, it may be argued that concentration measures alone are an inadequate guide to the impact of the merger on competition and that there are other factors which will ensure that the merger is unlikely to lead to reduced competition and higher margins for the merging firms.
- Second, it may be argued that even if the merged firm can widen margins following the merger, the merger creates other benefits which will offset this, such as cost savings, and these may lead to lower prices, despite wider margins.

One way of considering the issues is to see the problem in terms of efficiency gains versus reduction in competition.

Oliver Williamson's (1968) 'naive' trade-off model. (See diagram)

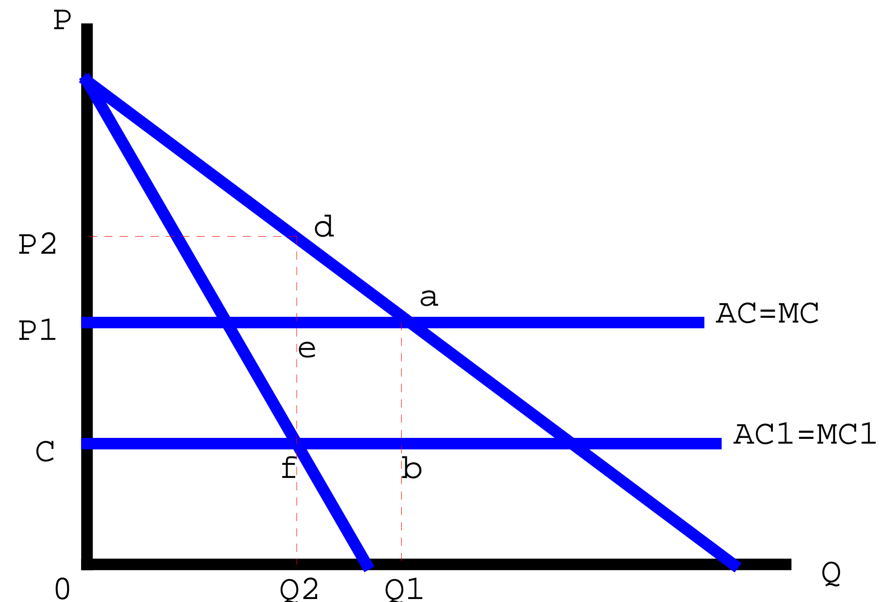


Figure 1: Williamson's 'naive' trade-off model of mergers.

Pre-merger

The equilibrium is P1, Q1,

Post-merger

- cost savings arise due to rationalisation, economies of scale or better management, hence AC1. If P1 is still charged consumers are no worse off and there are real cost savings on resources used P1abc

- If P2 is charged then consumer surplus loss aed has to be weighed against cost savings P1 efc. Indeed, Williamson showed that quite small cost savings offset large price rises with low price elasticity of demand. Note that whilst a proportion of the abnormal profit earnt by the monopolistic merged firm is the reward for cost savings there is also a transfer from consumers to producers (P1 P2 de) which might be construed a welfare loss under a Posnerian definition.

Of course the model has problems e.g. is the income (utility) of consumers who lose the same as that of producers who gain; will x-inefficiency result because of the merger and so on. However, the model provides for some pedagogic evaluation.

What though is the evidence on scale economies from post-merger studies?

A study by the Berlin based International Institute for management covering a 10 year period and 765 merger cases in Belgium suggested that mergers do not result in lower prices, improved efficiency, etc but are merely carried out so as to “build empires” (see El Agraa, 1994).

A Case Study

In 1998 the Commission also examined two planned mergers in the accountancy services sector, the first mergers ever notified in this sector. The first notification, concerning *Price Waterhouse/Coopers and Lybran*d, was shortly followed by the notification of a plan to merge *KPMG* and *Ernst and Youn*g. The sector as a whole is highly fragmented, consisting of many companies ranging from the very small to the very large. However, the Commission found that there is a distinct market for accountancy services provided to very big companies, mainly multinationals.

The providers of services to such companies must be able to offer a comprehensive service from a world–wide network of offices staffed by people with locally recognised qualifications and specialist expertise. There were only six significant competitors in this market and this number would have been reduced to four if both mergers had been carried out. However, the KPMG/Ernst and Young merger was abandoned after the Commission opened the Phase 2 procedure. The Commission therefore had to consider whether the Price Waterhouse/Coopers and Lybrand merger alone would create or strengthen oligopolistic dominance. The Commission found that the market presented some of the characteristics that are conducive to collective dominance, such as stagnant demand, little scope for innovation and transparent pricing. However, the merged entity would still face four large competitors and there was evidence that clients were willing and able to transfer their custom to other

accountancy firms in order to obtain better terms. Furthermore, there was considerable asymmetry between the competitors. The merged entity was much larger than its competitors, although its market share would have been less than 40% in any Member State. There were also large differences in the market structure in different countries. These factors suggested that the cost structures of the firms in the market were highly asymmetrical, making it difficult to sustain anti–competitive parallel behaviour. **The Commission therefore approved the merger.**

Source: European Economy Supplement A Feb 1999

Vertical Mergers

What is important is the existence of market power in at least one of the markets (upstream and downstream). If both markets were competitive increased vertical integration and foreclosure would have no negative impact on efficiency, because the prices in both markets would equal marginal cost regardless of the degree of vertical integration. In addition because of the problem of '**double marginalisation'**, if both firms had monopolies in their respective markets (bilateral monopoly) vertical integration would have a positive effect on efficiency.

Note too that vertical integration can raise the capital barrier to entry, result in price squeezes and facilitate collusion.

Conglomerate Mergers

Conglomerates may encourage **reciprocity** among their divisions to the detriment of smaller, independent sellers. They may engage in **cross-subsidisation** and they may create an atmosphere of **economic forbearance** whereby two companies in (say) the computer business may give each other an easy time for fear of retaliation in the car market where they also compete.

EC Policy on Mergers

Merger Control Regulation arose out of dissatisfaction with the application of Articles 85 (now Art. 81) and 86 (now Article 82) of the Treaty of Rome with respect to mergers.

The latter involves an *ex post* analysis but there was a need to have *ex ante* investigations into the likely future position of merging parties and market conditions to fulfil the idea of the Common Market.

Numerous attempts had been made since 1973 to control mergers but quarrelling between member states over threshold criteria created deadlock.

However, agreement emerged under the then Commissioner Peter Sutherland and in September 1990 a new competition law with respect to mergers came into force. (Leon Brittan took over upon its introduction)

Since that time proposed an EC task force must vet mergers, takeovers and Joint Ventures that meet certain criteria. They must discover whether the merger/takeover (with amendments for new merger rules from 1st March 1998)

- creates a concentration
  - i.e. arrangements whereby one or more undertakings acquire control of an undertaking and thus change the structure of companies and the market they operate in.
  - Joint ventures that increase concentration or involve cooperation.
- has a community wide dimension i.e.
  - a concentration with world wide annual sales of ECU 5 bn (**now ECU 2.5 bn**) and if EC wide sales are at least ECU 250 m (**now ECU 100 million**) (one exception is if each party derives over 2/3's of its sales from one and the same country).
    - Note 2 U.S. firms could come under this legislation if EC-wide sales are > ECU 250 m **(100 million**).
    - Note the 5 bn ECU figure is currently viewed as being too high by the Commission. Proposals announced in July 1996 would revise the threshold to 2bn ECU for worldwide sales and 150m ECU in sales at the EU level. **(Note the higher levels)**

Originally the regulation covered concentrative joint ventures, which is where two or more parent companies transfer their existing business into a joint venture and then exit the market. However, cooperative ventures (where the parents remain active in neighbouring markets) raised anti-competitive issues and took longer to process. This encouraged the parties to look to changing the status to concentrative. However to overcome this an important amendment now relates to **full function co-operative joint ventures**. This is where more than one of the parent companies remained on a market. These parents could operate as an independent entity and can be upstream, downstream or neighbouring the joint venture. Their presence could suggest dominance in the market, e.g. through the co-ordination of activities. At the moment these are in the e-commerce and telecommunications industry and represent an important development for knowledge based industries in the EU but thus far the Commission has not sought to prohibit such activities.

Procedures

No concentration may be put into effect before notification or within 3 weeks following notification.

Phase 1 ends after 4 weeks whereby the Commission makes a decision as to the concentration's compatibility with the common market.

If there are serious doubts about compatibility Phase 2 comes into effect and a 4 month investigation takes place.

Failure to abide by a Commission decision may lead to fines up to 10% of turnover of the undertakings concerned.

The Commission's decision is final though the Court of Justice acts as the body of appeal.

How does the Commission evaluate?

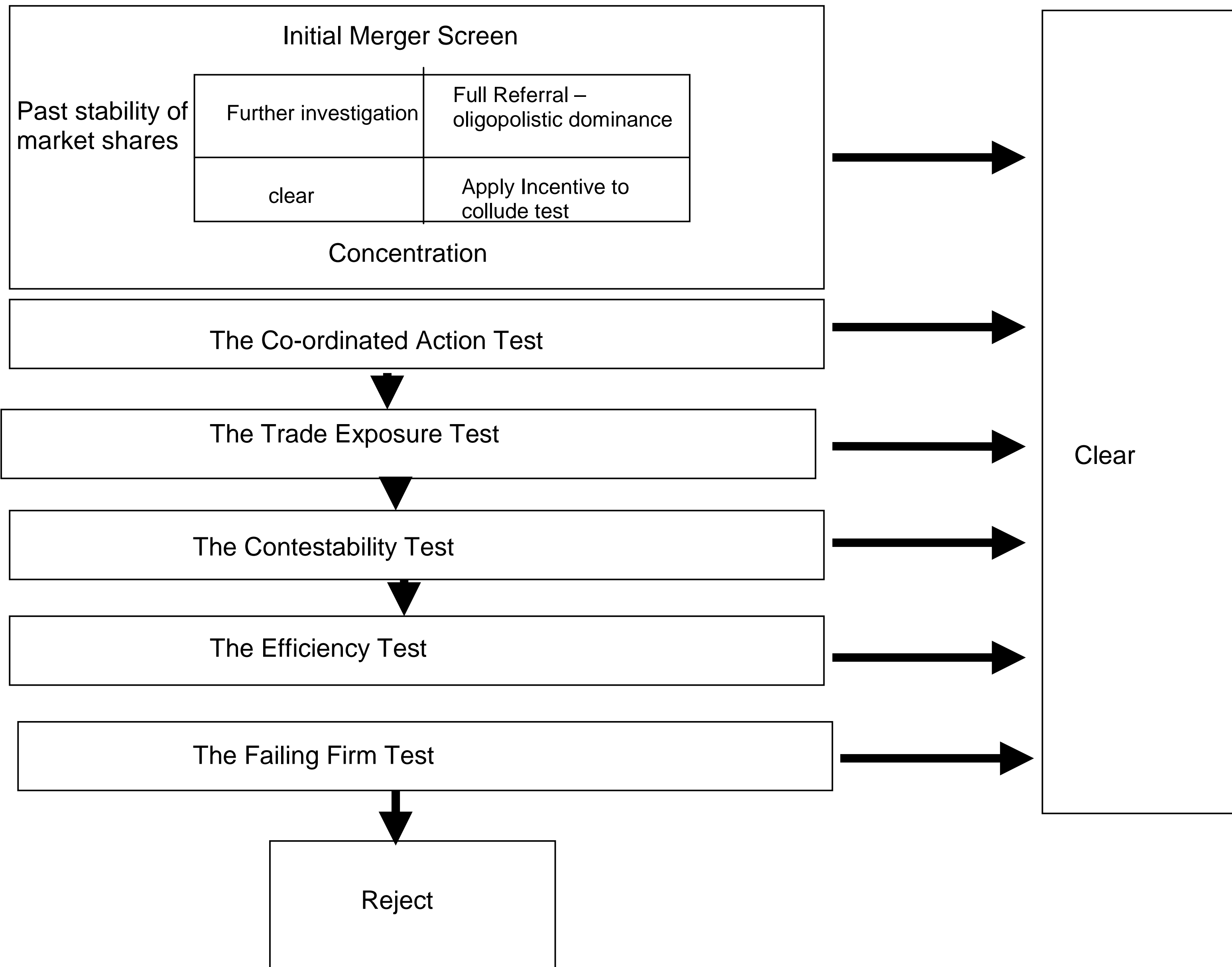
A distinct procedure has emerged for assessing notified mergers once Community jurisdiction has been established.

1. determine the relevant product market
2. determine the relevant geographical market
3. assess whether a merger creates or strengthens a dominant position

Four elements are examined:

1. the market position of the merged firm (market share and other competitive advantages)
2. strength of the remaining competitors
3. customers' buying power
4. potential competition

P. Williamson's expert evidence about how to assess mergers has been looked upon favourably by the Commission. The diagram below illustrates his method for evaluation.


Initial Merger Screen
Past stability of market shares
Further investigation
Full Referral – oligopolistic dominance
clear
Apply Incentive to collude test
Concentration
The Co-ordinated Action Test
The Trade Exposure Test
The Contestability Test
The Efficiency Test
The Failing Firm Test
Reject
Clear

Market shares are usually the starting point for assessment of dominance. Thus far the regulation is presumed to have no bearing on situations where market dominance is 25% or less. No reactions to a merger creating less than a 40% market share have occurred. However, every merger with a market share above 60% has at least triggered a phase 2 procedure.

The Commission has thus been concerned about oligopolistic as well as purely monopolistic dominance. Few of these have so far been drawn to the attention of the Commission. However, in the Nestle/Perrier merger the regulation was applied.

There are differing views about market shares according to the market under investigation: stable market shares over time and gaps between merged firms and the nearest rival point to market power; dynamic markets characterised by high rates of technological development are less entrenched.

Some, of course, would argue that there is no need for a policy; we should allow the market to develop unfettered. Mergers are thus about entrepreneurial endeavour. Collusive and monopolistic behaviour will break down.

Notifications under Merger Control Regulation

Between 1991 and end of 1995 the number of notifications has nearly doubled, from 63 to 110. The rise starting from 1994 (95 notifications).

From the time the regulations took effect until the end of 1999 1292 notifications have been made (49% were JVs, 39% were acquisitions of majority holdings). These breakdown as follows:

- 1027 cleared at phase 1(45 with undertakings)
- 51 withdrawn
- 51 fall outside the scope
- 9 full referral back to national authorities
- 58 required a phase 2 examination

Of the latter

- 36 were compatible with conditions and obligations
- 11 compatible without obligation
- 11 were prohibited
  - Aerospace/De Havilland (1991)
  - MSG Media Service (1994)
  - Nordic Satellite Distribution (1995)
  - RTL/Veronica/Endemol (1995)
  - Gencor/Lonrho (1996)
  - Kesko/Tuko (1996)
  - Saint Gobain/Wacker Chemie/NOM (1996)
  - Blokker/ Toys ‘R’ Us (1997)
  - Bertelsmann/Kirch/Premiere (1998)
  - Deutsche Telekom/Betaresearch (1998)
  - Air tours/ First Choice

Some of the Prohibitions

Aerospatiale-Alenia/de Haviland (1991)

The French state-owned Aerospatiale and Italy's state owned Alenia wanted to takeover de Havilland, the Canadian commuter turbo-prop subsidiary of Boeing. The French and Italians saw this as an industrial policy issue to establish naational champions. The Commission judged otherwise.

The proposed takeover would have given the French/Italian JV 50% of the world market and 67% of the EU market for commuter turbo-props for 20-70 seats (slightly more in the 40-70 seat range). Curwen and Gale (1993, European Business and Economic Development) suggest that this would have probably driven out 2 private EU producers, B. Aerospace and Fokker of Holland.

Awkward issues:

1. There was growing competition from developing country producers
2. Developed countries were moving over to small aircraft such as those planned by Airbus Industrie and Daimler-Benz and this would have dramatically altered the market share figures.
3. In February 1991, a merger of Aerospatiale's helicopter business with that of Germany's Messerschmitt-Bolkow-Blohm was approved despite the resulting JV leading to a 50% market share in the EU civilian helicopter business.

Early Cases that were not prohibited

Hong Kong and Shanghai Bank/ Midland (1992)

This case is interesting because it raises issues over competing jurisdictions. Once a bid by Lloyds Bank had been rejected by Midland HKS resurrected a merger plan which had collapsed in 1990. While the Commission was bound to investigate the HKS bid the Merger Control regulations meant that the UK Monopolies and Mergers Commission was equally bound to investigate any Lloyds bid, and both bodies might have chosen to investigate both bids. Indeed, it would have been sensible to have both bids examined simultaneously and given the overriding domestic considerations (accentuated by the fact that HKS's European assets were largely in the UK) suggests that primacy of jurisdiction should be accorded to the UK's MMC.

Brussels cleared the HKS bid arguing that HKS and Midland compete in very few sectors. Such a clearance prevents national regulators from undertaking an additional investigation other than under the exceptional circumstances outlined in Article 21 of the Treaty of Rome (which includes prudential banking rules as well as national security and media interests). The Bank of England did not deem such action appropriate in this case.

The Lloyds bid for the Midland was referred to the MMC a little after the Commission had initiated an inquiry into the HKS and Midland. After an appeal to the US Federal Reserve to invoke American banking law as a means to block the HKS bid failed, Lloyds withdrew its bid.

Unfortunately, this meant that the issue of overlapping jurisdiction was never put fully to the test.

Nestle/Perrier (1992/3)

Nestle put in a bid for Perrier supported by BSN, France's leading food manufacturer to whom it would sell Volvic. This would leave BSN with a share of the European mineral water market not far short of Perrier and hopefully protecting Nestle from monopoly proceedings.

Nestle managed to make a viable bid after lawsuits to take shareholding control away from the Italian Agnelli family. However, the Commission considered that Nestle and BSN would control some three-quarters of the French mineral water market. Elsewhere in the EU, however, neither company was thought to have more than 20% of any national market.

The Commission thus ruled that such a duopoly would be anti-competitive and ordered Nestle to sell 8 brands, about 20% of French capacity, to a single buyer before it buy Perrier. In 1993 the French Castel beverages company was persuaded to buy the 8 brands.

NSD (1995):

A proposed JV between Norsk TeleKom, TeleDanemark (largest cable operators in Norway and Denmark) and Industriforvaltings AB Kinnevik (a Swedish conglomerate which inter alia produces and distributes TV programmes and interests in telecommunications).

The Commission found that the JV would create a strong vertically integrated industry and a dominant position in 3 markets.

- the provision of satellite TV transponder capacity to the Nordic region
- the Danish market for cable TV networks
- direct distribution of pay TV and other encrypted channels to households.

Entry to the satellite TV market would be foreclosed and so was incompatible with the Common Market.

RTL/Veronica/Endemol (1995):

Respectively, the Luxembourg broadcasting company, Dutch commercial TV company and largest independent producer of TV programmes in the Netherlands. This case did not meet the turnover threshold but was referred to the Commission by the Dutch Government. A JV called HMG was to be formed to which RTL would transfer its 2 Dutch TV channels and Veronica its TV channel.

The Commission considered that there would be a strong advantage of co-ordinating programming and that HMG would have a dominant position in the market for TV advertising. Further, the vertical link between HMG and Endemol would strengthen the latters already dominant position in the Dutch Market for TV programme.

The Commission therefore ruled the merger incompatible with a common market.

Blokker/Toys'R'Us (taken from, European Economy. Supplement A- Economic Trends, Feb 1999)

The case of Blokker/Toys'R'Us 1997 did not have "a Community dimension" as defined in the Regulation but was examined by the Commission at the request of the Netherlands, which at that time did not have a national merger control system. The case concerned the acquisition by Blokker of six of the nine huge toyshops of Toys 'R' Us in the Netherlands. The other three shops were operated temporarily by Blokker pending their closure. Blokker is themarket leader in toy retailing in the Netherlands. The Commission found that even before the operation Blokker already had a dominant position in the relevant market, defined as the Dutch retail market for toys sold through specialist shops and shops with specialist departments. Although the market share added by the acquisition was quite small, the Commission came to the conclusion that the acquisition strengthened Blokker's dominant position by giving Blokker access to large suburban retail outlets and by creating new barriers to entry into the market. The operation was therefore declared incompatible with the common market. As it had already taken place, the Commission ordered Blokker to sell most of its shares in the subsidiary formed to operate the Toys'R'Us shops to a company capable of acting as an effective competitor.

Bertelsmann/Kirch/Premiere *and* Deutsche Telekom/Betaresearc*h (taken from European Economy, Supplement A - Economic Trends, Feb 1999)*

The prohibitions decided in 1998 occurred in two linked cases in the field of digital pay–TV: *Bertelsmann/Kirch/Premiere* and *Deutsche Telekom/Betaresearc*h. The provision of a package of digital pay–TV services involves the following chain of supply: programming content, broadcasting facilities, access to cable or satellite facilities, "set–top box" technology (for decoding signals and recording details for charging purposes) and a number of related technical services. The two operations in question would have established structural links

between the leading suppliers of all the elements of this chain in the German market. Premiere is one of only three pay–TV providers in Germany. The other two are DF1 and Canal+, which uses the technical platform of DF1. The Bertelsmann/Kirch/Pre-miere merger would have included the transfer of the assets of DF1, as well as Kirch's sports channel, DSF, to Premiere. Kirch has access to by far the biggest programme resources in Germany, notably pay–TV rights for Hollywood films and major sporting events, and also controls the "d–box" set–top box technology, which has been chosen by Deutsche Telekom for its cable network, the only cable network covering the whole country. The second operation would have given Deutsche Telekom joint control of Betaresearch, a wholly–owned subsidiary of Kirch, and with it the exclusive rights to the "d–box" technology for cable TV. Although there was no significant overlap between the parties in most of the product markets considered, the Commission forbade the mergers because they would have established vertical links which would have created or strengthened dominant positions in all the major links of supply chain.

Airtours/First Choice

The only prohibition in 1999 concerned the proposed acquisition by the British tour operator ***Airtours*** of its domestic rival ***First Choice.*** This was the first prohibition decision to be taken by the Commission on the ground of the creation of joint dominance by more than two firms. The parties' activities overlap mainly in the supply of leisure travel services in the UK and Ireland. Both parties are tour operators and they are also vertically integrated into the upstream market of airline operation and in the downstream activity of travel agency. The Commission considered that the main impact of the merger would be felt in the market for short–haul foreign package holidays sold in the U.K. In this market, Airtours/First Choice and two other leading vertically integrated tour operators would have had a position of collective dominance. The combined shares of these three firms in the package holiday market would have been about 85%, while no other firm has a market share above 5%. The Commission found that there are significant barriers both to new entry into the market and to the expansion of smaller firms and that the merger was likely to raise these barriers. It considered that upstream and downstream vertical integration – ownership of charter airlines and travel agencies –gives the major tour operators a strong advantage. Vertical integration also increases the transparency of the market, because operators buy aircraft seats from each other and use each other's travel agency networks to sell their package holidays.

A peculiar feature of the market is that the supply of package holidays is largely fixed well before sales begin (up to one year in advance), when the operators reserve aircraft seats and accommodation. Thereafter, an operator can in-crease its supply by, at most, 10% until February of the year in which the holiday takes place. Moreover, the operator incurs substantial cancellation charges if it reduces the number of holidays offered. Supply is therefore quite inflexible once the selling season has begun. In these circumstances, major tour operators have a strong incentive to re-strict supply rather

than to compete aggressively to gain market share, because of the risk that the market will be oversupplied, leading to a sharp drop in prices and consequently to losses for all players in the market. The Commission considered that this risk would be significantly in-creased by the reduction of the number of major operators from four to three and, hence, there would be an even stronger incentive for the remaining three to adopt a common strategy of restricting supply.

Issues for the Future

The Commission is worried by

- the growth of oligopolistic dominance.
    - The completion of the internal market could leave important markets dominated by a few firms - especially in sectors like airlines and telecommunications where single companies have dominated national markets.
- the very high thresholds
    - some sectors are so small that a community wide monopoly would not attract attention under merger regulation.
    - Member states have varying attitudes to referral for mergers under threshold values.

This is why the Commission has moved to lower thresholds.

However, there are still problems given the volumes of mergers in the EU and the rapid development of full function co-operative joint ventures. These have important implications for technological developments in the EU but may well raise important competition issues. The EC attitude thus far has been to allow joint ventures without conditions.

Reading and Further Reading

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