Challenges for EU Merger Control

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**Abstract**
The proposal to relax EU merger control to allow for anti-competitive "European Champions" may lead policy makers to update current merger control. While we see little merit in this specific proposal, we recommend a revision that goes into a different direction and, in particular, addresses mergers of potential competitors and the burden of proof. Thus, our proposal aims at the EC addressing problems of under-enforcement and making better-informed decisions. However, we would find it sensible to introduce in the Merger Regulation a clause whereby in exceptional and well-defined cases a merger, which would otherwise pass muster on competition grounds, may be prohibited due to defence, strategic and security of supply considerations.

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1. Introduction

Current EU Merger Control has been questioned by the German and French governments in the aftermath of the decision by the European Commission (henceforth, EC) to block the merger between Siemens and Alstom. Taking stock of established theory and recent empirical evidence, we also see the need to update European merger control regarding horizontal mergers. However, our suggestions go into different directions than the proposals by the French and German governments. While we see high degrees of concentration in some sectors and identify the risk that certain types of anti-competitive mergers are not blocked under current practice, the adoption of the proposal by the French and German governments may lead to the approval of clearly anti-competitive mergers. Some proponents claim that conditions in some sectors require larger scale to be able to compete in international markets as a justification for weaker merger control. We argue that this claim has limited appeal. Rather, the support for anti-competitive “European champions” appears to be based on questionable industrial policy goals, putting at risk advances in European merger control over the last twenty years.

In this paper, we raise a number of concerns in EU merger control regarding horizontal mergers. Our take on merger control is that there tends to be under-enforcement, as certain types of potentially anti-competitive mergers require closer scrutiny and the EC is in a disadvantaged position regarding the burden of proof. We point out that merger control should deal with the removal of potential competitors and that, to facilitate merger proceedings and allow for better-informed decisions, a reversal of the burden of proof is desirable. We also dispute the logic behind the proposal to relax merger control for large European firms.

2. Recent empirical evidence and well-established theory

According to the latest data made available by the EC, out of the 3457 mergers notified to it in the 2007-2017 period, only eight of them have been prohibited. On average, the EC’s intervention rate – that includes not only prohibitions, but also second phase withdrawals and mergers approved subject to remedies – has been around 7% (a similar percentage also applies to the period prior to 2007). These data signal that prohibitions are extremely rare events and that the EC believes that – if the merger is problematic – it can almost always fix it with appropriate remedies. Indeed, the EC has been resorting to increasingly

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2 Some empirical papers have found high and increasing concentration and rising market power in developed economies during the last decades. See e.g., Jan De Loecker, Jan Eeckhout, and Gabriel Unger, “The Rise of Market Power and the Macroeconomic Implications”, mimeo, November 2018. The existence and extent of such an increase is being actively debated, but several commentators have suggested that weak merger enforcement is one of the causes behind that increase.

3 Vertical mergers are not the focus of this paper, among other things because the effects of vertical mergers, traditionally seen as benign, are still the object of research and debate.

sophisticated merger remedies over the years, with standard divestitures representing a minority of cases.\(^5\) Being complex and untested, such remedies carry a considerable degree of uncertainty and therefore may not correct the anti-competitive effects of the merger, or only partially do so.\(^6\)

A low intervention rate may be an indication of under-enforcement of merger control by the EC,\(^7\) especially because theory tells us that horizontal mergers are anti-competitive unless they entail strong enough efficiency gains (and supposing that a large proportion of notified mergers contain horizontal elements). Admittedly, though, it would be desirable to have evidence that can speak more directly to the question of whether or not there is under-enforcement, and notably more ex-post assessments of EU merger cases based on “difference-in-differences” methodology. For the US, the evidence collected so far does seem to point to under-enforcement.\(^8\)

By using a different methodology, namely event study techniques, Duso et al. (2013)\(^9\) find that, after the 2003 reform, the EC has made errors of type II (unconditional clearance of anti-competitive mergers) for roughly 2/3 of the cases, and errors of type I (intervention in pro-competitive mergers) for roughly 1/3 of the cases,\(^10\) which can be read as indication of some under-enforcement of merger policy in the EU.

If empirical evidence is only sketchy and suggestive, from the theoretical standpoint the effects of horizontal mergers on prices are well understood and not controversial: absent efficiency gains the merger between two firms lead them to “internalise” the harm that aggressive pricing imposes on each other, and hence gives them an incentive to increase prices. This in turn pushes competitors, whose residual demand increases, to also raise prices (although typically by a lower percentage). Since all prices increase, the merger will harm consumers.\(^11\) It is also well established that horizontal mergers can increase the

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\(^5\) Over the period 2011-2017, standard divestitures represented 37% of the 116 merger remedies; complex divestitures including carve-outs, rebranding and IP divestitures account for 34% of cases; access remedies 16%; the remaining are other “non-divestitures” cases. See J. Brockhoff (2018), “The view from the Commission”, Presentation at the EU Merger Control Conference, 24 May 2018.


\(^7\) An alternative interpretation might of course be that anti-competitive mergers are not even considered by the firms because they foresee that such mergers would be blocked. However, the observation there is a trend towards using sophisticated merger remedies raises doubt on the validity of such an interpretation.

\(^8\) See e.g. Kwoka, John E., Jr. (2013), "Does Merger Control Work? A Retrospective on U.S. Enforcement Actions and Merger Outcomes", Antitrust Law Journal, 78: 619-50, that collects "retrospective analyses" of 46 US mergers finding that the overall mean effect of these mergers – a significant part of them involving remedies - is to raise prices by about 7%.


\(^10\) See Duso et al. (2013), cited above, table on page F609.

\(^11\) At first look less clear-cut, if firms primarily compete through capacities or quantities, absent efficiency gains, the merger between two firms lead them to "internalise" the harm that large installed capacity imposes on each other and, hence, gives them an incentive to cut capacity,
risk of collusion.\textsuperscript{12} Finally, \textit{absent efficiency gains}, a merger is also likely to affect negatively investment and innovation, by the same mechanism which leads to price increases: the merging parties will “internalise” the harm that aggressive investment imposes on each other and, hence, gives them an incentive to reduce it.\textsuperscript{13}

It is only if the merger entailed \textit{large enough efficiency gains} that merging parties’ prices may decrease after the merger, in turn leading to lower prices for outsiders and ultimately benefit consumers.\textsuperscript{14} Note, however, that the higher the market power held by the insiders the bigger must be the cost savings needed to outweigh the price effect.\textsuperscript{15} Further, if a merger involves two companies holding important market positions, it is more likely – other things being equal -- that such companies have already reached, or are close to, minimum efficient scale of their operations, which makes it more difficult that their merger would result in significant cost savings.

There are of course several considerations which may affect the magnitude of the upward pricing pressure created by the merger. These include the degree of concentration of the industry, lack of countervailing power of buyers, and the importance of barriers to entry.\textsuperscript{16}

\section{Whose burden of proof?}

These well-established theoretical results call for a policy approach whereby the approval of horizontal mergers should not be the default option. Currently, it is the Antitrust Authorities (AA) which have the burden of proving that a merger is anti-competitive. Instead, it would be more in line with economic thinking if the burden of proof was on the merging parties, which should demonstrate that they will achieve sufficient efficiency gains to compensate the upward pricing pressure created by the internalisation effect of the merger (or that barriers to

\textsuperscript{12} In this paper, we focus on unilateral effects and do not address coordinated effects. We note, however, that since the \textit{Airtours} judgment, the EC has raised coordinated effects concerns very rarely, in cases where documentary evidence showed past (attempted or successful) episodes of collusion. This is another likely source of under-enforcement in our view.


\textsuperscript{14} Similarly, only large enough efficiency gains entail the merging partners to expand their production after the merger.

\textsuperscript{15} If insiders have a tiny market share, their merger will likely affect prices only marginally, and consequently very small efficiency gains would neutralise the anti-competitive impact of the transaction; at the other extreme, a merger to monopoly would have a strong impact on prices; hence, very large efficiency gains would be needed to make the merger competitive-neutral.

\textsuperscript{16} Antitrust authorities may be too optimistic about entry being able to discipline incumbents after a merger. Often, imports or entry that should have prevented price increases do not materialize. For examples, see the report commissioned by the UK Competition and Markets Authority, “Entry and expansion in UK merger cases. An ex-post evaluation”, KPMG LLP, April 2017 (available at: https://www.gov.uk/government/publications/evaluation-of-entry-and-expansion-in-uk-merger-cases).
entry are so low, or countervailing power so strong, that it is unlikely the merger would raise prices).

The current situation where the burden of proof that the merger is anti-competitive falls upon AAs also has the drawback that in order to substantiate a theory of harm the AA needs data and information which the merged entity possess. This may result in situations where the merging parties withhold information, or they transmit it partially and with delay. Reversing the burden of proof would alleviate this asymmetric information problem, since the agent who possesses the information will have all the incentive to make use of it.

4. Safe harbour

Sure enough, this policy rule could be accompanied with a safe harbour approach: if both parties are small enough in terms of sales and assets, their merger is unlikely to raise prices by a significant amount (and even small efficiency gains may render it competitive-neutral). It would make sense, then, to allow such a merger without scrutiny in order to save resources of both the firms involved (which would otherwise have to prove efficiency gains) and of the AAs (which would have to check them).

An approach whereby the safe harbour is based on small market overlaps – and whereby for instance a leading firm could take over a small one because the latter would not add much to the former market share - would not be desirable because, absent the merger, the insiders might well compete with each other more fiercely than indicated by current market positions. In what follows, we consider examples of cases where a merger may be anti-competitive despite current market shares overlap being absent or minimal. This suggests that on top of structural presumptions based on market shares, additional concerns may need to be addressed.

(i) Potential competition: two merging firms may operate in adjacent (geographic or product) markets, but may contemplate entering each other’s market, and the right counterfactual to the merger would therefore be effective competition among them.

Possible examples of mergers removing potential competitors come from the digital sector. In recent years, Amazon, Apple, Google, and Facebook have been taking over dozens of small technology firms which have not marketed their products yet or were at an initial phase of roll-out. When one of these giants

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17 This is notwithstanding the obligation of merging parties to provide accurate and non-misleading information (Article 14 of the Merger Regulation).
18 Unfortunately, it is very difficult for AAs to find internal evidence showing market entry intentions. If some key assets (e.g., intellectual property, market data) are proprietary, difficult to replicate, and valuable in a particular market and possessed by a firm in an adjacent market, this may be an indication that market entry is likely by this firm.
19 To be able to investigate such cases at the EU level (without relying on referrals from national authorities), a reform of the notification thresholds is needed that would allow to investigate mergers involving firms with low or nil turnover but large market capitalisation.
takes over a small start-up with a very promising technology, which may develop into a substitutable product/technology, there may be a possible pro-competitive effect from this transaction: it is possible that, say, Google may further develop the search technology of a start-up, using its financial, technological and marketing clout, and incorporate it into its own search engine, whereas the start-up may have never been able to hit the market. However, it is also possible that the start-up may have further developed the technology and become a competitive threat to Google. Note that the pro-competitive effect (a marginal improvement in Google search engine) would likely be quite small when compared with the expected gain if the new technology had grown to challenge Google search (that, however, is a low probability event, but one with a huge benefit for the market).

Furthermore, after the takeover the acquiring firm may simply decide not to develop the technology at all, resulting in a “killer acquisition”, namely an acquisition motivated by the objective to extinguish a technology which would otherwise create future competition and dissipate industry profits. Cunningham et al. (2018) have gathered empirical evidence that documents the widespread existence of “killer acquisitions” in the pharmaceutical industry.

(ii) Potential entry via innovation. An insider is not active in the other merging party’s product market yet, but it is likely to be in the close future if the innovation (or investment) is currently making it successful. Several mergers in the pharmaceutical industry share this feature. For instance, in Novartis/GSK oncology, Pfizer/Hospira and Medtronics/Covidien, the EC found the merger would have suppressed drugs (or medical devices) which could have been approved. In each of these cases, one of the merging parties had already a drug in one (or more) particular market, while the other was in the process of passing the clinical trials.

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20 We are not suggesting that a small innovative company may not be taken over by any bigger company. The prospect of being bought by a more established firm is often an important driver of innovation. But a takeover by a large company which is the most likely to be impacted by the small firm’s new technology – should it be successful and reach the market – should be avoided. (Note that it is likely that the firm that stands to lose more from the new technology will be prepared to bid more for it. If it were a monopolist, for instance, it would be the highest bidder as long as the monopolistic profits are higher than the sum of the duopoly profits. See also the remarks on “killer acquisitions” below.)

21 See Colleen Cunningham, Florian Ederer, and Song Ma, “Killer Acquisitions”, Yale School of Management WP, 2018. By looking at the evolution of project development of thousands of drugs (their data cover about 25 years), they show that acquired drug projects are significantly more likely to be discontinued than those which have not been acquired. Likewise, a drug is significantly less likely to be continued in the development process in each year if it has been acquired.

22 But examples go beyond the pharma industry. In General Electric/Alstom (General Electric/Alstom (thermal power - renewable power & grid business), Case M.7278, 8 September 2015.) Alstom was active in the segment of large gas turbines, but not in the segment of very large gas turbines. However, the EC found that Alstom was at a very advanced stage with the development of a very large gas turbine (the so called GT36) and, therefore, looking forward, a likely competitor in the market.
More generally, in sectors such as pharmaceuticals (see above) and agrochemicals (see the recent Dow/Dupont, Bayer/Monsanto, and Syngenta/ChemChina mergers) firms heavily invest in R&D in a number of product categories. In some of them they may be successful today, in others tomorrow. So, the fact that they are currently not actively marketing one product (or one drug) does not mean that they will not be able to do so tomorrow.

(iii) Recent entry. Another instance where small market shares may not reflect the actual competitive constraints relates to cases where one of the insiders is a recent entrant in the market. Other things being equal, a firm with lower market share has more incentive to price aggressively: if the opportunities for price discrimination are limited, a marginal price decrease by a firm with large market size will determine a loss on the many infra-marginal units for any given extra unit sold, resulting in higher incentives to keep prices high; for a firm with small market size, the loss on only few infra-marginal units, giving it more incentive to behave aggressively.23

More generally, whenever one of the insiders is a recent entrant, looking at current market shares may under-estimate the competitive constraint represented by it, since a firm with a small market share may impose an important competitive constraint on the other firms prior to the merger. In this case, using the standard market share filter may lead to type-II errors.

5. Reforming merger control

As discussed so far, there are signals that merger control is currently under-enforced in the EU. However, as argued above, this does not mean that every merger should be prohibited. It is sensible to use a safe harbour approach whereby mergers of two companies both having small enough size should be allowed without any investigation. Since horizontal mergers involving at least one “large” firm may well be anti-competitive, everything else given, such mergers should not fall under the safe harbour. This includes situations in which the merging parties are deemed to be potential competitors.

The current situation where it is the AA which has to show that the merger is anti-competitive also requires the AA to rely on data and information which the merging parties possess and may not fully and promptly disclose. Allocating the burden of proof on the merging parties to show the merger is not anti-competitive would give them the incentive to make use of all the information they have.

This suggests that the policy approach should be different from the current one: Unless the merger falls within the safe harbour thresholds, the burden of proof

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23 The mobile telephony industry in Europe is a good example of these different incentives. Typically, switching costs push the companies with more established customer base to keep their prices higher than the recent entrants. This is often reflected in the market share of subscribers (a “stock” measure) differing significantly from the market share of “gross adds” (which reflects the “flows”, since it considers the new subscribers).
should fall upon the merging parties to make their case that the merger is unlikely to raise prices or reduce quality.

Note that this proposal shares some similarities with the current US approach, which establishes a rebuttable presumption that the merger is unlawful if it goes beyond a certain level and increase in concentration indices. The difference, however, resides in the fact that requiring a material change in concentration to trigger the presumption would not allow to deal with cases of potential competition or entry via innovation (see the above discussion). As such, our proposal is therefore closer to a recent law proposal by US Senator Amy Klobuchar whereby a merger is presumptively unlawful if merging parties' size (measured by assets, sales or market capitalisation) is above certain thresholds.

We are well aware that the proposal of reversing the burden of proof (or establishing a presumption of illegality beyond certain thresholds) would need a change in policy, but we believe that this would be well worth the effort of reforming the Merger Regulation (Council Regulation (EC) No 139/2004).

6. **Questioning merger control after Siemens/Alstom and the creation of “European champions”**

On February 6, 2019, the European Commission prohibited the merger between Siemens and Alstom, the leading European equipment providers in the rail industry (e.g., trains and signalling equipment). The German and French governments had lobbied for the merger (arguing it was necessary to create a European champion able to stand up to the powerful China's CRRC), and – after the prohibition decision – they have openly criticised the European Commission for it.

In the aftermath, calls to reform merger control have come from the French and German government. In their joint manifesto, they suggest to update “current merger guidelines to take greater account of competition at the global level, potential future competition and the time frame when it comes to looking ahead

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26 There are other changes in the merger regulation that are worth considering, including introducing provisions to deal with minority shareholding (related to the issue of common- and cross-ownerships which has raised a lot of interest recently), as has been proposed in the EC White Paper “Towards more effective EU merger control”, COM(2014) 449 final, July 9, 2014. For another change, see Footnote 18 above.
27 This section is taken largely verbatim from Massimo Motta and Martin Peitz, Competition policy and European firms’ competitiveness, February 20, 2019, Blog entry on Voxeu, https://voxeu.org/content/competition-policy-and-european-firms-competitiveness
28 “A Franco-German Manifesto for a European industrial policy fit for the 21st Century.” See https://www.bmw.i.de/Redaktion/DE/Downloads/F/franco-german-manifesto-for-a-european-industrial-policy.html, last checked March 13, 2019
to the development of competition to give the European Commission more flexibility when assessing relevant markets." This is made more explicit by the report "Nationale Industriestrategie 2030", released by the German Federal Ministry of Economic Affairs and Energy in which it calls for a rewriting of merger control and additional industrial policy measures aimed at making some large European companies even larger and more profitable. This campaign runs under the buzzword “European champion” and comes with the claim that approving anti-competitive mergers is in the public interest: "Often German or European mergers, which are meaningful and necessary in view of the world market, fail because of the focus on national and regional markets under current law. European and German competition law must be reviewed and, if necessary, amended so that German and European companies can compete at international level on an equal footing.”29

There is nothing in European merger control that prevents the creation of European (or, for that matter, national) champions, provided that the merger brings about sufficiently strong synergies and complementarities to merit the name “champion”. But in the Siemens/Alstom case, there is no public information that points to such synergies, and the European Commission stated that the parties have not substantiated any such efficiency claims.

Absent efficiencies from the merger, the elimination of competition between two firms has likely anti-competitive effects both in the short and in the long term. In the short term, because it would inevitably lead to higher prices and less choice for direct customers and ultimately final consumers; in the long term, because lower competitive pressure is likely to translate into lower incentives to innovate, invest, improve product offerings. Therefore, in cases like Siemens/Alstom where the merger does not entail efficiency gains, it is hard to see how it could have promoted a more-competitive “European champion”, whereas it is straightforward to see it would have harmed customers (which, unsurprisingly, strongly opposed to the merger).

Based on the findings of the European Commission, the Siemens-Alstom merger appears to be a clear-cut case of a merger that hurts final consumers in Europe. However, both firms also compete in international markets and the claim has been made that a merged company would be more competitive in those markets.

The only case where European merger control may conceivably be in contrast with the objective of creating a European champion who is more successful in international markets could be one where the merger entails some efficiency gains – thereby making the merged entity more competitive in world markets –

but not sufficiently strong to outweigh harm for European consumers. In other words, due to the merger, prices of the products of the merged entity would increase in Europe, whereas more units would be sold in international markets (with positive effects on European profits and, possibly, employment).

It would be important to clarify in the policy debate that we are only concerned about such cases.\textsuperscript{30} However, we fear that under the cover of enabling the forming of anti-competitive “European champions”, short-term political goals that enjoy quick popular support would guide decision-making. Further, under European competition law, firms could also pursue less anti-competitive avenues to obtain efficiency gains without impacting negatively upon European consumers. For instance, European firms may form a joint-venture (or other agreement) allowing them to coordinate foreign production and sales, thereby attaining most of the efficiency gains that the merger could have achieved. Provided that the joint-venture does not have an impact on the European market, it would be approved by the European Commission.\textsuperscript{31}

Public policy considerations other than economic efficiency may be present in any competition law, and the EU is no exception.\textsuperscript{32} The Merger Regulation itself (at Article 21) allows EU countries to invoke some specified policy considerations (public security, plurality of the media and prudential rules) in merger control. This would allow them to block mergers that the EC would otherwise allow.

We might also think of other situations where policy relying uniquely on efficiency criteria may lead to undesirable outcomes, such as cases affecting security of supply, or military, or otherwise strategic considerations: it might well be the right thing to do, in some situations, to prohibit particular non-European firms from taking over a European firm operating in the energy, defense, or other strategic sectors. However, these are reasons to prohibit mergers that may not be anti-competitive. We would find it much harder to make the opposite case, that is, to allow anti-competitive European mergers because of these policy goals.

Beyond mergers, competition policy may lack the possibility to intervene (or to intervene in a timely fashion) against unfair practices by non-EU firms. Suppose for instance that a non-EU firm (possibly, a state-controlled enterprise) is

\textsuperscript{30}Based on the findings of the European Commission, Siemens/Alstom could have definitely not been one such case.

\textsuperscript{31}Article 2.2 of the Merger Regulation says: "A concentration which would not significantly impede effective competition in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position, shall be declared compatible with the common market." (Our emphasis) Moreover, the “Commission Notice of 5 December 2013 on a simplified procedure for treatment of certain concentrations under Council Regulation (EC) No 139/2004” explicitly states that a JV which will have no effects within the EU will be subject to the simplified procedures, as it is not likely to raise competition concerns.

\textsuperscript{32}After all, one of the pillars of the EU Treaty is the objective of ‘economic integration’, which has been interpreted by the EU Courts in such a way as to prevent firms from applying different trade conditions in different EU countries. The prohibition of price discrimination across countries would not otherwise be prohibited on standard competition policy or efficiency grounds.
engaging in below-cost pricing in some EU market. If that firm is not dominant, abuse of dominance provisions (article 102 of the Treaty) may not allow the European Commission to intervene. If it was dominant, the European Commission could intervene, but for various reasons it may take too long before the case is decided, and a long-lasting damage may have occurred if that practice has led to the exit or to underinvestment by affected European firms.

Competition rules may not be enough to deal with such cases, then. In some markets, this may leave us with either some preventive intervention, such as excluding from tenders non-EU firms suspected to engage in such behavior, or to resort to anti-dumping provisions. But facilitating the use of such instruments carries the risk that they are used for protectionist aims rather than for dealing with unfair practices by non-EU countries. With a public policy intervention in place that eliminates non-EU competitors, strong competition among European firms becomes essential to avoid harm to European consumers and European competitiveness. Otherwise, firms operating in European markets would be insulated from competitive pressure, leading to higher prices in the short term and likely less innovation in the long term.

To sum up, there may well exist instances where public policy considerations beyond competition considerations could play a role in competition enforcement in general and in merger control in particular, but they should be exceptional, very precisely defined, and taken from a precise set of rules. Above all, they should obey to the principle of proportionality: namely, they should achieve the stated objectives and should not go beyond what is necessary to attain them. Allowing anti-competitive mergers are unlikely to pass the test.

7. Summary

The proposal to relax EU merger control to allow for anti-competitive “European Champions” may lead policy makers to update current merger control. While we see little merit in this specific proposal, we recommend a revision which goes into a different direction and that, in particular, addresses mergers of potential competitors and the burden of proof. Thus, our proposal aims at the EC addressing problems of under-enforcement and making better-informed decisions. However, we would find it sensible to introduce in the Merger Regulation a clause whereby in exceptional and well-defined cases a merger that would otherwise pass muster on competition grounds may be prohibited due to defence, strategic and security of supply considerations.