**EUROPEAN COMMISSION**

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# EU Merger Control: The Big Picture

Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

Sixth Annual GCR Conference
**Brussels, 12 November 2014**

Competition

## EU Merger Control: the Big Picture

Thank you very much for this invitation. The organisers have marketed this event as "The conference about the bigger picture". For this reason, and in order not to disappoint anyone who has been attracted by this title, I will focus on two "big picture" items in my intervention today:

A) Merger control as a key component of the EU economic agenda after the crisis.

B) The adequacy of the legal framework for merger control to face current challenges.

In doing so, I will rely extensively on the Commission's White Paper *Towards more effective EU merger control* published in July, and present the proposals for reform it contains.

### Merger control as a key component of the EU economic agenda

Merger control is a cyclical business. The evolution of mergers & acquisitions (M&A) activity is normally correlated with GDP growth or, more precisely, with expectations of GDP growth. Merger control activity has been quite stable in recent years. After a notifications peak in 2007 (402 notifications), there was a sudden reduction of the number of cases. In recent years this has remained quite stable, at around or just below 300 annual notifications.

In 2014, in particular in the second half of 2014, we are starting to see a change in this trend. Since the summer, cases have been increasing compared to the same period last year. At the end of October, we had received 259 notifications compared to 219 at the same time last year.

This trend reflects the broader recovery of the EU economy in recent months. As the economic forecast presented last week by the Commission shows, the EU growth rate this year will be 1.3%, increasing to 1.5% in 2015 and 2.0% in 2016. It is neither a very strong recovery nor a recovery without risks, but economic activity and confidence are increasing. And growth as well as growth expectations are fuelling a surge of M&A activity across Europe. Other factors explaining this re-launch of M&A could be the healthier and less leveraged accounts of companies in Europe and the low cost of financing due to low inflation.

In this context of recovery, M&A activity presents important opportunities for the European economy: it contributes to industry restructuring and therefore to more competitive European players, and it can be a vehicle for increased investment in the EU economy, both of which are very necessary to consolidate a healthy and sustainable recovery.

However, M&A activity also presents some risks. It is important that restructuring does not negatively affect the competitive structure of sectors of the European Economy. A reduction of competition in a given sector could have several negative effects for the EU economy as a whole, even beyond the economic sector affected by the concentration, and therefore hamper the prospects of economic recovery.

First of all, let us look at the static effects of anti-competitive mergers. The most immediate short-term impact is normally a price increase for the products in question. If the concentrations arise in input or intermediary goods markets, they can have a negative impact on European companies that use those inputs downstream. Indeed, increased costs of inputs lead to increased production costs and to an immediate worsening of the competitiveness of those producers.

This explains why, in recent years, some operations have been forcefully opposed by EU producers. Among others, I recall BHP Billiton/Rio Tinto, Glencore/Xstrata or more recently Solvay/Ineos. The increased concentration that could have resulted from these operations could have led to higher prices in iron ore, zinc or PVC respectively and thus to higher costs for industries that use these inputs, such as the steel industry in the case of iron ore. Thanks to intervention by the Commission, these negative effects did not materialise.

But the negative effects of anti-competitive concentrations are not limited to decreased competitiveness of downstream producers. Higher prices in general and operations that directly affect final customers in particular have an impact in the form of reduced purchaser power ("pouvoir d'achat") and lower consumer demand, which should be one of the drivers of sustained recovery of the European economy in the coming years.

However, these static knock-on downstream effects that I have just described are not the worst consequences of mergers that reduce competition. The most harmful effects are of a dynamic nature. Indeed, productivity has to be the key driver of sustainable growth in the EU in the coming years. The beneficial effects of competition for productivity and innovation are widely recognised: competitive markets create incentives for firms to increase their internal productivity, that is to become more efficient in order to stay ahead of rivals; they force less efficient rivals out of the markets, thus improving the overall industry productivity; and finally, they also push firms to develop new products and to invest and innovate.

A concentration that reduces competition may, in the short term, make life easier for the operators in these markets by allowing them to raise prices. In the medium and long term, however, these operations will negatively affect the competitiveness of the whole industry by reducing incentives to increase efficiency and innovate.

There are plenty of examples of EU-players that have become world leaders precisely because they faced a very competitive market structure at home, which incentivised them to increase efficiency and innovate. The German top-end car manufacturers, BMW, Audi and Mercedes-Benz, with headquarters separated by only a few hundred kilometres, are one good example of this.

The key challenge of merger control in the EU is to ensure that the positive impact of M&A activity in terms of restructuring and investment is preserved to the greatest extent possible without negatively affecting the competitive structure of the markets concerned. As I have just explained, the costs of anti-competitive mergers are high, not only for consumers but more broadly for the competitiveness of the EU industry. A merger control system that meets this challenge will significantly contribute to economic recovery in the EU.

How does EU Merger control meet this challenge?

First of all, the existence of merger control at the EU level is, in itself, a way to meet this challenge. The fact that operations among large companies with an impact in a number of Member States can benefit from a one-stop-shop system and do not need to be assessed in 28 different jurisdictions decreases administrative costs, increases legal certainty and removes obstacles to pan-European restructuring. This idea was explicitly mentioned in the preamble of the first merger regulation (next year we will celebrate the 25$^{th}$ anniversary of its entry into force) as a major reason for its enactment.

Over the years, we have further improved the one-stop-shop system by implementing an effective system of referrals that has considerably reduced the number of cases that are actually notified to multiple jurisdictions. We can still do better, though. As I will explain later, the White Paper includes some proposals to this end.

Secondly, it is worth noting that most of the M&A are neutral from a competition point of view. The Commission intervenes in only a handful of cases every year. If we look at figures for the most recent full year, 2013, we see that the Commission examined 277 cases. Of these, it only intervened in 15 cases. In the end, it prohibited two and authorised 13 operations subject to conditions, while it approved all others unconditionally.

In view of the large number of unproblematic operations it is important that the administrative costs to examine them are kept as low as possible. This is why, in December 2013, the Commission adopted a merger simplification package that reduces red tape and makes procedures simpler and shorter for non-problematic mergers. By the end of October, the new simplified procedure has been applied to 66 per cent of the cases, close to the 70% we initially expected. Further simplification measures, including the abolition of the notification obligation for simpler cases, have been proposed in the White Paper that we will discuss later.

Third, even in the limited number of cases in which the Commission intervenes, prohibitions remain the solution of last resort. In fact, since the Merger Regulation came into force in 1990, the Commission has cleared more than 5000 deals and blocked only 24, which is less than 5 per thousand cases. If we add to this the conditional decisions with remedies and cases withdrawn in second phase (which can usually be attributed to the Commission's intervention) the total intervention rate currently stands at 7%.

In view of these figures, it is difficult to argue, as we sometimes hear, that merger control is an obstacle to beneficial consolidation in the EU markets.

Prohibitions have been necessary as an exceptional measure when competition problems could not be remedied. The most recent example is the prohibition, for the second time, of Ryanair/Aer Lingus in 2013. There was strong evidence that this operation would have raised prices for a number of air routes to and from Ireland, harming millions of passengers. In most cases, however, solutions can be found that allow the merger to go ahead while eliminating the competition problem. I will discuss these complex cases and our remedies policy in a minute. At this point, let me simply note that many companies that you would qualify as "European champions" are the result of mergers that were approved by the European Commission, such as EADS (now rebranded Airbus group), leading EU airline groups such as BA/Iberia or AF/KLM, leading energy conglomerates such as Total/ELF or GDF/Suez, or top pharma groups such as Sanofi/Aventis.

Now let us examine in more detail how we assess these complex cases. I will use recent examples and figures from an analysis of the merger decisions of the last years to illustrate some key and, sometimes, controversial issues.

***Market definition***

The first step of any merger assessment is the definition of the relevant markets. The market definition serves to frame the analysis of a merger's impact on competition; it identifies the effective alternatives available to customers of the merging companies, and allows market shares to be calculated, which are a meaningful starting point for an analysis of competition forces.

Let me be very clear on this point: market definition is not a policy statement. A market definition is based on the business reality; it is a factual and empirical analysis undertaken on a case-by-case basis. It is far from being a bureaucratic assessment – markets are investigated afresh with every case, by seeking up-to-date hard facts like sales data and trade statistics and by asking for the current views of customers and suppliers. Defining a market is, by its very nature, a dynamic exercise. The Commission needs to predict the most likely developments after a merger and takes into account future developments that can already be foreseen. Equally, no market definitions are carved in stone; indeed, they are revisited if evidence shows that circumstances have changed over time.

In recent years, mostly from within the business world, it has been questioned whether the Commission's geographic market definitions are perhaps too narrow. Today, many companies operate on a global scale and compete with a variety suppliers in different parts of the world. From their perspective, markets should always be defined as global.

However, a market definition exercise is essentially a customer-focused exercise; it is about looking at customers in a given area and finding out which alternative suppliers are realistically available to them. In this context, the decisive question is not whether the companies are active globally but to which alternative suppliers customers in a geographic area could turn in the business reality.

In fast-moving markets like consumer goods or beverages, national markets are prevalent because of product characteristics, branding and marketing strategies, and national tastes and preferences. These factors determine that competition will take place on national (or even local) levels. In other market types such as mobile telephony, for instance, mobile networks operators sell their services on national levels primarily due to regulatory restrictions. I will come back to telecoms cases later.

By contrast, for markets in which the products or services are purchased by customers on a global scale, the Commission has in numerous cases found worldwide markets in various industries, such as information technology, natural resources and mining, or avionics.

For instance, when Western Digital, a manufacturer of hard disk drivers for use in computers, acquired the competing business Hitachi, the Commission identified a worldwide market: customers, in particular computer manufacturers, source hard disk drivers on a global basis, the prices for hard disk drivers are broadly similar on the different continents, and the customer needs do not vary between regions.

Another example was the attempt to combine BHP Billiton and Rio Tinto, in which the Commission investigated competition in the field of iron ore. The seaborne market for imports from iron mines in Australia and Brazil did not only include customers in the EU but from around the globe, including Korea, Japan and China, due to the fact that transporting iron ore by sea is relatively inexpensive and a global price-setting mechanism exists.

If we look at the figures, it is interesting to note that in the period 2012-2013, the market was defined as purely national in only 30% of the Commission's merger decisions, contrary to some perceptions. The sectors in which the percentage of national markets was higher were for example beverages, soaps and detergents, telecoms and food products, which in all cases is due to product characteristics or regulatory barriers.

On the opposite side, we found sectors such as chemicals, basic metals, consumer electronics or aircraft manufacturing, in which the markets were defined as encompassing the EEA or a wider area in more than 90% of the cases.

It is also worth noting that, over time, the Commission's geographic market definition also seems to be broadening. If we compare decisions from two periods, 2003-2004 and 2012-2013, we see that merger cases where the market was defined as the EU or wider increased from 48% to 61%. This figure can be partly explained by the changing nature of mergers with a community dimension, for instance by progressive increase in percentage of cross-border deals, and by market integration in several sectors of the European economy.

Overall, both the examples and the statistics that I have just presented show that the Commission does not have any bias in favour of narrow geographical markets. It assesses the realities of each case on its own merits and is open to revising its views when circumstances change and markets evolve.

***Competitive assessment***

Once the relevant markets have been defined, the Commission will assess whether the merger eliminates important competitive constraints to the merged entity. In this regard, it is important to note that market definition is only a starting point. The Commission will assess whether the merged entity will continue to face competition constraints not only from within but also from outside the market. For this purpose, the

Commission will systematically take imports into account in its competitive assessment and assess the possibility of future entry into the market by players located outside it.

It is impossible to do justice to the diversity of merger control merely by giving a few examples of Commission assessments, but let me mention two different groups of recent cases that can help to illustrate this point better.

Firstly, the Commission has had to assess a number of industrial mergers in the EU in recent years. I am referring to cases such as Outokumpu/Inoxum or SSAB/RAUTARUUKKI in steel, Ineos/Solvay in PVC or, more recently, Rockwood/Huntsman in chemicals.

In all these cases, the Commission was confronted with similar features. They concerned mergers of two of the leading players in mature and concentrated EU markets, into which entry was unlikely due to the high investment required. Markets were characterised by overcapacity. Imports from outside, (if any) were not sufficient to constrain the merged parties. In all these cases, price increases were likely and would have not been offset by any efficiencies. The Commission ended up requesting the divestiture of parts of existing businesses in order to restore competitive pressure.

In all these cases, the Commission's intervention preserved Europe's industrial base while ensuring continued competition in the relevant sectors, which was often essential to protect downstream producers from increasing input costs. The Nordic steel case is particularly telling in this regard: this operation created a "European champion" in the market for speciality steels, with a world-wide dimension. While the Commission did not have any concerns to raise in this respect, it did request remedies for flat steel products, an area in which the merger would have led to high concentration levels and would have harmed Nordic companies that require such flat steel inputs in their production processes.

Secondly, the Commission has recently examined a number of mergers in the telecoms sector. In particular, there have been decisions in three mobile telephony deals in Austria, Ireland and Germany.

In these cases, the markets were always defined as national. National telecom regulators define frequencies and allocate spectrums. The scope of these spectrum allocations outlines the area in which operators compete. And this is what defines the relevant geographic market. Every time users cross a border, their devices switch to a new network operator. In order to avoid roaming fees, users need a new contract when taking up residence in another Member State. Therefore, mobile network operators still compete on a national basis, even if they are owned by larger, sometimes pan-European or even global operators. National markets are further defined by aspects are familiar from other industries, such as brand names or consumer preferences. For instance, we observe quite different patterns of pre-paid or post-paid mobile phone contracts in various Member States. Similarly, customers use cell phones for data access to a much larger extent in some countries than in others, which affects the way mobile operators compete in the market.

All of the three mergers that we examined were four –to–three operations. Because a competitor vanishes from a concentrated market, these always require attention. This is perhaps even more the case in telecoms, because new entry is particularly difficult. A new operator has to acquire scarce spectrum, needs to set up the network, which involves building thousands of masts and installing antennas, backbone and IT environment, and has to comply with regulatory requirements for setting up a network. The operator has to establish marketing, sales, customer service and support structures, and invest heavily in customer acquisition. It also has to negotiate national and international roaming agreements. Therefore, if a merger has anti-competitive effects, these can be long-lasting.

It would not be appropriate to make generalizations across markets. Each country has different regulatory conditions and, consequently, different competitive landscapes. These specificities have to be taken into account particularly when assessing these mergers and devising appropriate remedies. In the three cases at hand, however, the Commission concluded that the operation would have been likely to eliminate important competitive pressures that previously existed in the market, leading to a price increase. Remedies were requested as a condition for approval of the operations.

***Remedies***

This brings us to the Commission's remedy policy. The principles are clear: the Commission has an established preference for structural remedies; the divestiture of a business remains the norm. This reflects the experience accumulated by the Commission over many years. Competition is more effectively restored by replacing one of the disappeared parties by a standalone business, than by regulating the merged company with behavioural remedies. This also directly addresses changes to the market structure brought about by the merger.

If we examine all remedies accepted in the period 2010-2013, which encompasses 43 different cases, divestitures represent 72 per cent of all remedies. Access remedies, for instance to slots in airline mergers, represent 19 per cent and other types of remedies, such as breaking links with a competitor, represent the remaining 9 per cent. These statistics reveal a strong consistency between the policy expressed in the Remedies Notice and its implementation in individual cases.

Let me make only a brief reference to the remedies that the Commission accepted in the mobile telephony cases, particularly those in Ireland and Germany. To ensure that new players will enter the market, the Commission compelled the merging parties to sell up to thirty per cent of their network capacity to Mobile Virtual Network Operators. The Commission attached several important conditions to the remedy.. First, all the capacity had to be divested before implementation of the merger. Second, in previous cases where similar remedies had been proposed (e.g. Austria), the merging parties only committed to sell capacity to MVNOs when they needed it, on a “pay as you go” basis. In Ireland and Germany, by contrast, the MVNOs will pay for a fixed amount of capacity at a fixed rate. The need to recover cost gives them an incentive to attract as many customers as possible, by presenting them with attractive offers. This upfront sale of capacity makes the impact of the remedy similar to a structural divestiture, in other words, consistent with overall Commission policy.

To conclude this first part of the speech: in the light of the steady increase of M&A activity in the EU, merger control will continue to be a key component of competition policy in the coming years. I have explained how merger control ensures that concentrations harm neither competition nor competitiveness while at the same time preserving to the greatest extent possible their positive impact in terms of restructuring and investment. I believe that a solid merger control system has to be seen as a modest but indispensable element of any policy mix that attempts to steer the EU economy onto a path of sustainable recovery.

Let me move now to the second part of this speech.

## The Regulatory environment for EU Merger Control

10 years have elapsed since the last reform of the EU Merger Regulation, promoted by Commissioner Monti in 2004. It is a good time therefore, to look back and see how these reforms have actually functioned.

This analysis, developed in detail in the first part of the White Paper published by the Commission last July, reveals that we now have a broadly satisfactory substantive framework for merger assessment. The new test introduced in 2004, developed by accompanying guidelines, ensures that our assessment is focused on the likely negative effects of the merger. The new test not only removed possible gaps in assessing mergers in oligopolistic markets, but also facilitated a more economically sound analysis of vertical operations. And, as a further result of the reforms, the analysis of efficiencies has now become a common feature in any in-depth investigation.

In the last ten years, this substantive framework, together with improved procedures and checks and balances, has ensured a near-100 per cent success rate before the EU Courts.

It cannot be denied that investigations of difficult mergers have become more complex, and that economic submissions and detailed analysis of internal documents play a more important role than ten years ago. At the same time, as I have already mentioned, we have further streamlined the treatment of non-complex cases and reduced the information requirements.

In these ten years, the convergence between the assessment of mergers at EU and national level has also increased markedly. Referrals between these two levels, facilitated by the 2004 reforms, have now become very frequent. This, together with increased market integration, ensures that the Commission meanwhile rightly focuses its analysis mostly on cross-border operations (85 per cent of cases in 2013 were cross-border, up from 74 per cent in 2004).

Overall, therefore, calls for a major overhaul of the system do not seem warranted.

Nevertheless, one of the positive features of EU merger control, and, I would dare to say, of EU competition policy more broadly, is its ability to periodically question its rules and principles and come up with ways of improving them.

This is precisely what the second part of the White Paper adopted last July attempts to do. It focuses on two main issues: first, it suggests to expand the scope of merger control and to deal effectively with harmful acquisitions of minority shareholdings, and second, it proposes to further streamline and reduce red tape, in particular concerning referrals.

The fact that the acquisition of a minority stake in a competitor, even if short of control, can create anti-competitive harm is well established. I will not develop this point further here. But while in other jurisdictions these acquisitions fall within the scope of merger control, this is not the case in the EU.

The White Paper proposes to remedy this gap, in a way that would not create undue or disproportionate burdens for business. The modalities proposed to achieve this have been at the centre of the public consultation that was launched by the White Paper. Let me describe them in some detail here.

First of all, the Commission proposes to target acquisitions of minority shareholdings that are most harmful to competition. In order to identify these, it uses several criteria. First of all, we propose to only target acquisitions involving a competitive interaction between the players, either because they operate in the same sector or because they have a vertical relationship. Second, the relative size of the acquired shareholding plays an important role: all acquisitions would be covered above a certain threshold (around 20 per cent of the total capital), but there would also be a safe harbour below a certain threshold (5 per cent). Between the two thresholds, other criteria will apply. In particular, the Commission proposes to cover operations in this interval that also give the buyer board representation, veto rights beyond those of a normal minority shareholder, or particular access to commercially sensitive information.

Secondly, the Commission proposes a relatively simple procedure. In a nutshell, the notification obligation would not apply to these operations. Parties would only have to provide a limited information notice. It would be up to the Commission to decide whether an in-depth investigation of either party is required. In this case, a normal notification would be required and the deadlines of the Merger Regulation would apply. If this is not the case, the acquisition would be considered approved after a short delay (4 months) without any further administrative act.

With these two devices, a targeted jurisdiction, and a transparency mechanism, as opposed to a full notification procedure, the White Paper proposal can be seen as well-balanced. It would ensure that the Commission has the appropriate tools to examine and prevent harmful acquisitions of minority shareholdings, while limiting costs for both business and the administration.

The White Paper also includes proposals to simplify the referral of cases between the Commission and Member States. For instance, it would allow the parties to directly notify Brussels in cases that would have to be submitted to at least 3 Member States, without the need to first present a referral request (Form RS), as is currently the case. In any case, Member States would retain their veto right. This would eliminate red tape and substantially reduce the time needed to deal with these pre-notification referrals. Proposals are also developed that serve to streamline and make more efficient post-notification referrals from MS to the Commission, in particular by modifying Article 22 of the Merger Regulation.

The White Paper also reflects on eliminating the notification obligation for simpler concentrations. Indeed, it considers extending the transparency mechanism initially devised for minority shareholdings to some categories of full concentration, such as those where there are no overlaps between the activities of the parties.

This is not yet a legislative proposal. These are well-thought-out reforms, but they can still be modified. A public consultation has just ended, and the numerous views and suggestions for improvement that were received are welcome. The paper and the replies to the consultation will serve as a basis for reflection for the new Commissioner and College, who will have to decide whether and how to move forward with this reform.

Thank you very much.