CONGLOMERATE MERGERS, CONSUMER GOODS AND THE 'EFFICIENCY OFFENSE' DOCTRINE

A. Jorge Padilla and Andrea Renda

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(draft)

Abstract

The differences existing between US and EU standards for merger appraisal were almost ignored by most US practitioners and scholars until recently. The decision issued by the European Commission on July 3, 2001 on the proposed GE/Honeywell acquisition simply pierced the veil, highlighting the contours of a starkly divergent approach in merger appraisal by the competition authorities on the two sides of the Atlantic. The EC is viewed as having developed a so-called 'efficiency offense doctrine', i.e. "a concern that the merger could make the merged entity too efficient and consequently threaten the future of competitors". As a result, many commentators expressed concerns on the alleged tendency, by the EC, to interpret competition policy as a tool to protect competitors instead of competition. We argue that, although it is correct to state that the EC applied an 'efficiency offense doctrine', this does not mean that the EC's final goal is to protect competitors instead of consumers.

1. INTRODUCTION: THE EC UNDER ATTACK

The differences existing between US and EU standards for merger appraisal were almost ignored by most US practitioners and scholars until recently. The decision issued by the European Commission (EC) on July 3, 2001 on the proposed *GE/Honeywell* acquisition simply pierced the veil, highlighting the contours of a starkly divergent approach in merger appraisal by the competition authorities on the two sides of the Atlantic. The EC's decision elicited a number of critiques. Some commentators criticized the EC merger control procedure, others expressed the concern that the EC's decision in GE/Honeywell was aimed at protecting EU-based companies to the disadvantage of US competitors[1]; moreover, most comments highlighted the EC's (mis)use of economic theory in merger appraisal. In this paper, we will focus on this last strand of objections.

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[1] We consider this interpretation to be erroneous. Recall that GE/Honeywell's strongest competitors in the relevant markets were US-based companies (such as Pratt&Whitney).

The critics have articulated two claims, After the EC decision in GE/Honeywell, the economists supporting GE have argued that the EC developed an 'efficiency offense doctrine', i.e. "a concern that the merger could make the merged entity *too efficient* and consequently threaten the future of competitors"[2]. Furthermore, the US enforcement authorities, who had ealier granted clearance to the GE/Honeywell proposed acquisition, severely criticized this approach, stating that the EC interprets competition policy as a tool to protect competitors instead of competition[3], whereas the US authorities protect aggressive competition that benefits consumers, even if it leads to the reduction of the sales and market share of the merged entity's competitors[4].

Commissioner Mario Monti has in several occasions rebutted both claims: as he recently stated, "I would at once like to refute the assertion that the European Commission, when dealing with conglomerate mergers, is in fact applying what has been dubbed an 'efficiency offense'."[5] Regarding the alleged EC pro-competitor bias, Monti also recently recalled that "competition policy puts markets at the service of consumers (...) after all we say that the consumer is king".[6]

In this paper, we argue that both Commissioner Monti and its critics are partly right (and partly wrong). The critics are right when they argue that the EC has been developing an efficiency offense doctrine. The EC views conglomerate mergers that allow the merging parties to price more aggressively or that make the merged entity's products more appealing at given prices, as potentially incompatible with the common market. Yet, this does not mean that the Commission is aiming at protecting competitors. To the contrary, the EC is convinced that, whenever a merger causes the exit of competitors from the market, some of the efficiencies generated by a conglomerate merger will not be passed on to consumers in the medium term, and that – as a consequence – the merger will exert a negative impact on consumer welfare from a dynamic standpoint. Hence, the EC attempts to

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[2] http://www.lexecon.co.uk/publications/media/2001/ge_honeywell-mixed_bundling.pdf

[3] According to William Kolasky, the Justice Department official responsible for international antitrust, "we view the EU approach to conglomerate mergers as inconsistent with the central tenet of US antitrust policy – that the antitrust laws 'protect competition, not competitors". See *Conglomerate mergers and Range Effects: It's a long way from Chicago to Brussels*, 10 George Mason L.Rev. 533 (2002).

[4] For a complete description of the legal and economic issues arising in *GE/Honeywell*, see David S. Evans & Michael Salinger, *Competition Thinking at the European Commission: Lesson from the Aborted GE/Honeywell Merger*, 10 George Mason L.Rev. 489 (2002).

[5] See Monti's speech, *Antitrust in US and Europe: a History of Convergence*, General Counsel Roundtable, American Bar Association (ABA) Washington, DC November 14, 2001.

[6] See Monti's speech 00/207, *European Competition Policy and the Citizen*, European Competition Day, Lisbon, 9 June 2000.

protect competitors in order to pursue its final goal – protecting competition and consumer welfare.

In this paper, we attempt to de-mistify the idea that the EC's efficiency offense doctrine aims at protecting competitors instead of fostering aggressive competition. In our opinion, it is certainly true that the EC adheres to a more structuralist, less "Darwinian" view of competition than the corresponding US authorities and that this leads the EC to a weaker faith in the taumaturgical virtues of the market in the long run. From this perspective, the EC approach to conglomerate mergers was seen as closely ressembling the theories of competitive harm adopted in the US in the 1960s and in the 1970s, during the so-called 'merger wave'.

We proceed as follows. Section 2 briefly confronts the evolution of conglomerate merger review in the US with the few, recent rulings issued by the EC on conglomerate mergers involving consumer goods. Indeed, a closer look at EC's caselaw reveals that *GE/Honeywell* was just the tip of an iceberg. The rationale adopted by the EC closely ressembles the arguments used in earlier decisions – such as *AT&T/NCR*[7], *ATR/de Havilland*[8], *Guinness/Grand Metropolitan*[9] – and in subsequent rulings, such as *Tetra Laval/Sidel*[10]. *GE/Honeywell* was simply the first case in which the EC ever blocked a merger which had been granted clearance by the US antitrust authorities.

Section 3 contains an economic analysis of conglomerate mergers and develops a checklist under which the application of an 'efficiency offense' doctrine might prove viable from an economic standpoint. In our view, the problems associated with the theory of competitive harm adopted by the EC are not related to the theory in itself: what is more important is whether the theory fits the facts of the case.

In Section 4 we analyze a case of conglomerate merger involving consumer goods – *Guinness/Grand Metropolitan*, a merger between two producers of spirit brands in many national markets, which was granted clearance by the EC, but only after the merging parties had accepted heavy commitments. We find that the EC applied an 'efficiency offense' doctrine, whose economic grounds are anyway somewhat shaky.

Section 5 concludes, by highlighting the major points of contention still open for discussion about the EC attitude toward efficiencies in conglomerate mergers.

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[7] Case No. IV/M.050, January 18, 1991.

[8] Case No. IV/M.053, October 2, 1991.

[9] Case no. IV/M.938, October 15, 1997.

[10] Case No. Comp/M.2416, January 30, 2002.

2. THE ASSESSMENT OF CONGLOMERATE MERGERS IN THE US AND IN THE EU

2.1 Conglomerate mergers in the US

In the US antitrust enforcement, the attitude towards conglomerate mergers has noticeably changed over the last four decades. In the period 1964 through 1977 – during the so-called 'third merger wave' – there were eleven successful judicial challenges to conglomerate mergers; on the contrary, not a single one occurred after 1974, and until the 1982 Merger Guidelines. During this period, there were 22 unsuccessful attacks on conglomerate mergers, 12 of which took place between 1974 and 1977. After the 1982 Guidelines, for reasons also due to the advent of the Chicago School in antitrust, most of the concerns arising from conglomerate mergers were relaxed.

Currently, the US authorities are strongly in favor of an *ex post* approach to conglomerate mergers. That is, *if* a conglomerate achieves a dominant position in the market *and* abuses its position to the disadvantage of consumers, *then* the US authorities will inhibit the abusive behavior as exclusionary conduct under Section 2 of the Sherman Act. But the merger will not be blocked before the competitive harm materializes.

The US authorities developed an 'efficiency defense doctrine' especially after the 1992 Merger Guidelines. Yet, such doctrine does not imply that any merger producing efficiencies should be cleared. As former FTC Chairman Pitofsky has stated, "except in the most extraordinary circumstances, efficiencies should not vindicate an otherwise illegal transaction."[11] In addition – contrary to what currently happens in the EU competition policy – short-term efficiencies will generally carry more weight than long-term effects, since the latter are less proximate and less predictable. Under the 1992 Merger Guidelines – as revised by the DoJ and the FTC on April 8, 1997 – "[e]fficiencies almost never justify a merger to monopoly or near-monopoly."

[11] See Pitofsky, *Efficiencies in Defense of Mergers*, Speech at the Antitrust Symposium of the George Mason Law Review, "The Changing Face of Efficiency", Washington, D.C., October 16, 1998 (available at http://www.ftc.gov/speeches/pitofsky/pitofeff.htm).

2.1.1. Four theories of competitive harm

During the 1960s and the 1970s, there were four theories suggesting that conglomerate mergers might have anticompetitive effects and should therefore be challenged under Section 7 of the Clayton Act. It is useful to shortly describe those theories of competitive harm, since many commentators consider the current EC attitude towards conglomerate mergers as closely related to the approach adopted in the US before the ascent of the Chicago School.

2.1.1.1. Potential Competition Theory

This theory may refer to both the 'actual/potential entrant' approach – when a merger eliminates a company on the fringes of a market, which could at some time enter the market on its own, "thereby adding to the number of market forces, contributing to the vigor of competition, and diminishing the market share of existing companies"[12] – and the 'perceived potential entrant' approach – whenever the proposed merger eliminates a company which exerted some effect on incumbents, even without actually entering the market.

The leading cases which adopted the potential competition approach can be traced back to the 1960s. In particular, both in *US v. El Paso Natural Gas* (1964) and in *FTC v. Procter & Gamble* (1967), the theory of potential competition led to a challenging of the proposed merger. The theory of potential competition was then reappraised by the Supreme Court a decade later, in two geographic extension mergers, *US v. Falstaff Brewing Corp.* (1973) and *US v. Marine Bancorporation* (1974)[13]. In both cases, the Court recognized the applicability of the potential competition doctrine, though refusing to apply it to the specific case at stake[14].

Today, the theory of potential competition has been completely set aside: a merger between potential competitors is seen as a horizontal merger and may be challenged only under the Horizontal Merger Guidelines.

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[12] See Bauer, *1982 Merger Guidelines: Government Enforcement Policy of Section 7 of the Clayton Act: Carte Blanche for Conglomerate Mergers?,* 71 Calif. L. Rev. 348 (1983), note 7.

[13] The potential competition theory is sometimes referred to as '*Loss of the most probable entrant theory*'. See Swennes II, *Three Theories of Potential Competition under Section 7 of the Clayton Act: Reaching the Conglomerate Merger*, 49 Tul. L. Rev. 139 (1974), at 143.

[14] Hovenkamp, *Merger Actions for Damages,* 35 Hastings L.J. 937 (1984), at 965.

2.1.1.2. *Entrenchment Theory*

This theory refers to the acquisition of a smaller company by a firm of significantly greater size and strength. According to such theory, the acquisition may 'entrench' the smaller target company, making competition by its rivals more difficult, raising barriers to entry and reducing the likelihood of future entry by other companies. The financial strength of the acquiring firm is the main ground for application of such theory – the so-called 'deep pocket theory' belongs to this strand.

According to an ABA recommendation on Antitrust Law, "The entrenchment doctrine is essentially based on three concerns: (1) the 'deep pocket' resulting from the merger will discourage entry; (2) the deep pocket will also permit the target firm to engage in predatory conduct, such as pricing below marginal cost, and (3) the merger will enable the target company to achieve certain economies not available to other firms".[15] As is easily noticed, this approach is amazingly similar to an 'efficiency offense doctrine'.

The leading case in which the entrenchment theory was invoked is again *FTC v. Procter & Gamble* (1967)[16]. The acquired firm, Clorox, was the leading manufacturer in the "heavily concentrated" household bleach market, with a 49 percent share of national sales and higher shares in some local markets; on the other hand, the acquiring company (*Procter & Gamble*) manufactured various household cleaning products (but not bleach), and had assets fourty times those of Clorox. The U.S. Supreme Court found ample evidentiary support for the FTC's findings that Procter & Gamble, "with its huge assets", might have underpriced Clorox in order to drive out competition, subsidizing the underpricing with revenue from other products. In addition, Clorox would have had the advantage of Procter & Gamble's large marketing and distribution system and quantity discounts in advertising, which would have given Clorox a cost advantage over its competitors. The Court also expressed the concern that firms would restrain their competitive efforts for fear of the retaliatory or financial power of the merged firm, and decided to block the merger.

The entrenchment theory was tentatively embraced by the 1968 Merger Guidelines, issued shortly after the *Procter & Gamble* decision, and was the basis for a number of subsequent decisions issued by the US antitrust

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[15] See Joffe, Kolasky, McGowan, Mendez-Penate, Edwards, Ordover, Proger, Solomon & Toepke, *Proposed Revision of the Justice Department's Merger Guidelines,* 81 Colum. L. Rev. 1543, (1981) at 1570.

[16] 386 U.S. 568 (1967).

agencies[17]. The theory was then completely abandoned with the 1982 Merger Guidelines[18], after fierce criticism arising from major commentators, including the ABA[19] and Robert Bork[20].

2.1.1.3. Reciprocity Theory

This theory refers to the case in which two companies merge in order to enhance the possibility of reciprocal business dealings.[21] The leading case for this approach is *FTC v. Consolidated Foods*[22]. Yet, since 1971 no conglomerate merger has been challenged on the basis of such theory[23], although some scholars found evidence of a revamping in recent times[24]. The application of this theory normally followed three steps: (a) the merger must significantly increase the opportunities for reciprocal dealing by creating a market structure conducive to reciprocity; (b) there must be a reasonable probability that those opportunities will be exploited, and (c) the resulting reciprocal dealings, if any, must have a tendency substantially to lessen competition.[25]

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[17] See Bauer, *supra* note 12, at 357.

[18] *Id.,* at 575. According to Charles James, "The abandonment of the Procter & Gamble entrenchment theory in the United States was a clear step forward in the application of sound economic thinking to merger enforcement and of rigorous application of the principle that antitrust laws protect competition, efficiency and consumer welfare rather than individual competitors" See James's speech at the seminar sponsored by the European Commission's Directorate General for Competition and the U.S. Mission to the European Union in Brussels, Belgium, *Antitrust in the Early 21st Century*, May 15, 2002.

[19] See Joffe, Kolasky, McGowan, Mendez-Penate, Edwards, Ordover, Proger, Solomon & Toepke, *supra* note 15.

[20] The Antitrust Paradox (1978). "[t]he Procter & Gamble decision makes sense only when antitrust is viewed as pro-small business -- and even then it does not make much sense, because small business is protected from Clorox's cost advantages only when they happen to be achieved through merger." Far from "frightening smaller companies into semiparalysis," Bork argued that conglomerate mergers that generate efficiencies will force smaller competitors "to improve, rather than worsen, their competitive performance," leaving consumers better off.

[21] See Cavanagh, *Reciprocal Dealing: a Rebirth?*, 75 St. John's L. Rev. 633 (2001). The theory of reciprocal dealing emerged from an influential stream of literature starting from the 1950s. See, e.g., Edwards, *Conglomerate Bigness as a Source of Power*, in NBER, Business Concentration and Price Policy (1955), 331.

[22] *FTC v. Consolidated Foods Corp.*, 380 U.S. 592, 594-95 (1965).

[23] *United States v. ITT Corp., 1971 Trade Cas.* (CCH) P 73,169 (N.D. Ill. 1971).

[24] Cavanagh (2001), *supra* note 21, *passim*. Another famous case in which a conglomerate merger was challenged on the basis of the reciprocity theory is *United States v. Kennecott Copper Corp.*, 1971 *Trade Cas.* (CCH) P 73,437 (S.D.N.Y. 1971).

[25] Cavanagh, *supra* note 21, at 637, quoting *Carrier Corp. v. United Tech. Corp., 1978-2 Trade Cas.* (CCH) P 62,393, at 76,371 (N.D.N.Y. 1978).

2.1.1.4. Bigness is Badness Theory

This theory – recently invoked also for the GE/Honeywell case – suggests that certain mergers are undesirable simply if they unite two already extremely large companies[26].

2.1.2. A comment

The current interpretation of Section 7 of the Clayton act is clearly at odds with the entrenchment theory developed in *FTC v. Procter&Gamble.* The most common approach is that conglomerate mergers should not be challenged, if not for their horizontal and/or vertical effects.

Condemning a merger on the ground that it may enable the merged firm to drive rivals from the market through greater efficiency and lower, but non-predatory, prices would also be inconsistent with the development of the US antitrust laws with respect to predation. The Supreme Court has emphasized that it would be contrary to the purposes of the antitrust laws to condemn "low" pricing that is "above an appropriate measure of costs" as "predatory" simply because it injures a less efficient competitor.[27]

The acknowledgment of the welfare-enhancing aspects of most conglomerate mergers in the US was accompanied by a gradual relaxation of the standards adopted for assessing the competitive impact of tying arrangements. In many cases, conglomerate mergers are indeed challenged because they allow tying and bundling of separate products, and this in turn might lead to leveraging of market power from the tying product market to the tied product market. In the US, tying has been considered as a per se antitrust violation since 1958[28]. Early caselaw shows a strong hostility towards tying, at least until *Jefferson Parish*[29], a case concerning the tying of hospital services and anesthesiological services. In that case, the Supreme Court recognized that "not every refusal to sell two products separately can be said to restrain competition". *Jefferson Parish* introduced a modified per se approach, in which "the criteria for tying are used as proxies for competitive harm and, arguably, efficiencies" [30].

[26] See Bauer, *supra* note 12, at 354.

[27] See, *contra*, Edlin, *Stopping Above-Cost Predatory Pricing,* Yale L.J. 941 (2002); and the reply by Einer Elhauge, available at http://www.law.harvard.edu/faculty/elhauge/pdf/predatory.pdf

[28] See *Northern Pacific Railway v. US,* 356 U.S. 1, 5-6 (1958).

[29] *Jefferson Parish Hospital Dist. No. 2 v. Hyde,* 466 U.S. 2 (1984).

[30] See Christian Ahlborn, David S. Evans & A. Jorge Padilla, *The Antitrust Economics of Tying: a Farewell to* Per Se *Illegality*, forthcoming on *Antitrust Bulletin*, 2003.

Finally, the ruling of the Court of Appeals in *Microsoft III* introduced a rule of reason approach towards tying. The Court challenged the District Court's application of the modified per se approach under *Jefferson Parish*, by explicitly finding no reason to argue that product integration "should be 'conclusively' presumed to be unreasonable and therefore illegal without elaborate inquiry"[31].

Such change was fundamentally supported by the Chicago School economists, which reached the conclusion that tying is in most cases beneficial, in that it may reduce production, distribution and transaction costs, while enhancing product quality[32]. Furthermore, the Chicago School argued that there is no possibility of leveraging a monopoly position in one market in order to obtain extra profits elsewhere. This result is known as the 'single monopoly profit theorem', and clearly supported the view that tying should be treated as per se legal.

In short, the remarkable change observed in the US approach to conglomerate mergers is closely related to changes in the US antitrust approach to tying and leveraging, as well as to changes in the economic theory. The recent development of the so-called 'post-Chicago' theory has somewhat reconsidered the scope of Chicagoan theoretical achievements, by showing that, in some circumstances, tying may serve anti-competitive means. The post-Chicago theories, anyway, did not question that tying may in many circumstances be welfare-enhancing, thus endorsing a rule of reason approach.

2.2 Conglomerate mergers in the EU

While in the US the theories leading to an increased challenge of conglomerate mergers have gradually been abandoned after the 1982 Merger Guidelines, in the EU the so-called "portfolio effect" or "range effect" theory has been increasingly favored by the Commission. As we already pointed out, this approach is surprisingly similar to the 'entrenchment theory' adopted in the US in *FTC v. Procter & Gamble.*

In 1989, the EC stated in its Annual Report that ''[c]onglomerates can, more readily than other enterprises, adopt predatory strategies by using their financial (...) forbearance: where conglomerate firms have an overlapping

[31] *U.S. v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001)

[32] See Christian Ahlborn, David S. Evans & A. Jorge Padilla, *supra* note 30.

presence in a range of markets, they may be reluctant to compete against each other.''[33]

According to the head of the EC Merger Task Force, Gotz Drauz[34], "[a]lthough there is no explicitly stated framework for the analysis of conglomerate mergers either under the EC Merger regulation or in other jurisdictions, there is a general agreement that the analysis of conglomerate effects has to undergo a certain number of steps." Such steps are identified as; *a)* the definition of the individual products/services, and their evaluation in the combined product range; *b)* the assessment of leveraging opportunities; *c)* the examination of the specific characteristics of the market; and *d)* the assessment of the existence of market power or dominance in at least one of the pre-merger products.

The most relevant cases of conglomerate mergers involving consumer goods within the EU competition law are *Coca Cola/Amalgamated Beverages*, *Guinness/Grand Metropolitan*, *Pernod Ricard/Diageo/Seagram Spirits* and *AOL/Time Warner*. In what follows, we give a brief description of the most relevant issues arising in *Amalgamated Beverages*. Section 4 below contains an economic analysis of the *Guinness* case.

In its decision in the case *Coca-Cola/Amalgamated Beverages GB*[35], decided in 1997, the Commission examined whether the constitution of a broad range or portfolio of soft drink brands would confer on the Coca-Cola Company the possibility of using its beverage portfolio to its advantage, for instance by *leveraging* its strong position in the market fo colas (the "tying market") into other products of the portfolio. The concerns of the Commission were related to commercial tying through pressure on downstream agents.

The Coca Cola brand was considered as a *must-stock brand*, a circumstance that – according to the EC – remarkably strengthened the merged entity's bargaining power vis-à-vis buyers: "Colas are (…) sometimes referred to as a 'traffic builder' (…). Therefore, it is a considerable advantage for a supplier to have a strong cola brand in its portfolio."[36]

The EC considered the issue of commonality savings and price flexibility, and stated that "[t]he wide portfolio enables [Coca Cola] to structure its discounts so as to encourage retailers to purchase the largest possible volume. Overrider discounts (…) encourage customers to maximise their

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33 (XIXth Report on Competition Policy (1989), p. 228.

34 See Drauz, *Unbundling GE/Honeywell: The Assessment of Conglomerate Mergers under EC Competition Law*, 25 Fordham Int'l L.J. 885, April 2002, at 886.

35 Case No IV/M 794, January 22, 1997.

36 *Id.*, *§67.*

purchases from a particular supplier and create substantial disincentives for customers to change suppliers."[37]

Interestingly, in *Amalgamated Beverages* the EC reaffirmed its reliance on market structure as a proxy for competitive market outcomes. Thus, the decision recited: "the proposed operation leads to a *structural change which may also lead to a change in the market behaviour of [Coca Cola]*".[38]

2.2.3 A comment

The EC approach to conglomerate mergers supports the view that the EU competition policy puts high emphasis on *ex ante* structural remedies as opposed to *ex post* behavioral measures. The attitude towards efficiencies in conglomerate mergers has however changed over the last few years. Consider what the EC stated in the "OECD Roundtable on *Competition Policy and Efficiency Claims in Horizontal Agreements*", held in Paris in 1996, that "[t]here is no real possibility of justifying an efficiency defense under the Merger Regulation"; now, compare it with this recent statement by Gotz Drauz: "I wish to categorically reject the criticism that the European Commission does not recognize an efficiency defense"[39].

According to Drauz, the EC only considers those efficiencies that bring about "a long-term and structural reduction in the marginal cost of production and distribution, which comes as a direct and immediate result of the merger, which cannot be achieved by less restrictive means and which reasonably will be passed on to the consumer on a permanent basis, in terms of lower prices or increased quality"[40].

The strict standards applied in the assessment of conglomerate mergers are, indeed, consistent with the stronger hostility exhibited by the EC competition law approach towards tying, if compared with the US approach. In the (few) tying cases it examined, the EC adopted very low thresholds for establishing anti-competitive effects. An assessment of the EC approach based on cases such as *British Sugar* and *Hilti* reveals that the EC is very close to considering tying arrangements under a *per se* rule[41].

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[37] *Id., §148.*

[38] *Id., §214.* (emphasis added).

[39] Drauz, supra note 34, at 905.

[40] *Id.*

[41] See Ahlborn, Evans and Padilla, *supra* note 30.

3. CONGLOMERATE MERGERS: EFFICIENCIES, PRICES AND CONCERNS

Conglomerate mergers are defined as mergers between firms that are neither actual nor potential competitors. As a consequence, Conglomerate mergers usually do not raise concerns by the competition authorities. Such transactions do not eliminate a competitor from the market, nor determine an immediate increase of one player's market share; hence, they are unlikely to match either the 'substantial lessening of competition' criterion adopted in the US, nor the 'creation or strengthening of a dominant position' test applied by the EC. Indeed, these transactions have been challenged by the US authorities and by the EC only in a handful of cases.

However, in some circumstances conglomerate mergers can actually raise competitive concerns. This usually occurs in the following cases:

- when they enable tying, leveraging and foreclosure problems, without creating countervailing efficiencies.
- when they allow the merging parties to price more aggressively or to market a more appealing good, jeopardizing the rivals' economic viability on the market and thus leading to competitors' exit.
- when they allow the merged entity to produce a full line of products, which the entity can force its downstream customers to purchase.

This is usually the case for conglomerate mergers uniting complementary goods. Such mergers create short-run efficiencies for consumers, but might also foreclose the market to those competitors who cannot match the tie-in, the lower prices or the full-line offer of the conglomerate. In most cases involving consumer goods, conglomerate mergers enable an efficient product tying or bundling and/or significant demand economies of scope. In the case of efficient tying/bundling, the resulting efficiencies will be directly enjoyed by final consumers, while in the case of commonality savings intermediate buyers (such as wholesalers) will profit from one-stop-shopping, and will then (arguably) translate the cost saving downstream to final consumers.

A competitive assessment of conglomerate mergers typically implies both the evaluation of the short-run and long-run impact of the merger on the degree of competition observed in the market. Below, we give an overview of possible efficiencies and concerns that arise from the assessment of a conglomerate merger, with specific focus on conglomerate mergers involving consumer goods.

3.1 Short-run effects: efficiencies and prices

Conglomerate mergers are sometimes rather tricky transactions from the standpoint of economic analysis. They can produce short-run efficiencies, which in the medium term end up lowering consumer welfare. Yet, what is efficient in short-run might turn out fenabling foreclosure over a longer time horizon. A taxonomy of short-run efficiencies includes:

- **The 'Cournot effect'**: this relates to conglomerate mergers uniting complements. That is, complements may be priced lower if offered by the same firm in a bundle. This effect is similar to the well-known double marginalization problem in the analysis of vertical integration, and is widely known as 'Cournot effect', since it was first described by Augustine Cournot back in 1838. A firm monopolizing the market for two complementary products would charge lower prices than would two separate monopolists setting each a different price. The combined producer will indeed maximize its profits across the two goods, while each separate provider would price each good at the individual profit-maximizing price;
- **The 'quality assurance' effect:** in many cases, the merged entity can engage in efficient bundling, by producing a bundle of goods that is worth to consumers more than the sum of its parts. This is a very common occurrence in tying cases, and ultimately does not imply that prices will be lower. There will be an increase in consumers' willingness to pay for the bundled good[42].
- **Cost synergies:** efficiency gains might occur in any kind of conglomerate merger, not only in mergers uniting complementary goods. Indeed, economies of scale and scope might arise not only in production, but also in distribution.
- **Reduced Transaction Costs:** whenever the merged entity is able to produce a wide range (or a full line) of products, customers might benefit from 'one-stop-shopping'. As we already mentioned, this occurs both for final consumers and for intermediate customers such as wholesalers and retailers. This effect might anyway significantly decrease the degree of countervailing buyer power in the market, in

[42] See Ahlborn, Evans and Padilla, *supra* note 30.

that it determines a situation of economic dependency in the buyer-seller contractual relationship and, as a consequence, an increase in the merged entity's bargaining strength vis à vis downstream players. We will return to this peculiar effect in Section 4, along with the description of the EC approach in *Guinness/Grand Metropolitan*.

In short, conglomerate mergers are likely to create a more efficient competitor on the market. As a result, the merged entity's products will be more attractive for consumers, both in terms of product quality (quality assurance effect) and in terms of lower prices (reduced production, distribution and transaction costs, Cournot effect). We would expect competitors to respond to the merged entity's increased efficiency by pricing their products more aggressively. The merged entity will thus face two different effects: *a)* an increased competition from its rivals; and *b)* an increased consumer willingness to pay for its products. The economic theory predicts that the former effects will typically dominate the latter, and that the merged entity will be led to behave competitively and lower its prices.

The resulting effect on prices and profits is unambiguous. Prices will certainly be lower, to the benefit of consumers. As far as profits are concerned, as competitors decide to price more aggressively, their profitability will certainly decline. On the other hand, the merged entity will increase its profitability, even if it lowers prices.

3.1.1 Short-run competitive assessment

The short-run efficiencies resulting from a conglomerate merger should be considered in the competitive assessment carried out by competition authorities. A competitive assessment of the impact of conglomerate mergers implies the choice of a standard. Below, we assume that competition authorities can choose among three different criteria for evaluating the competitive impact of the proposed merger.

3.1.1.1 Consumer welfare standard

The ascent of the Chicago School in the US antitrust has led to a thorough debate on the goals to be pursued by the antitrust authorities. As a result, it is nowadays undisputed that consumer welfare is the one and only goal of antitrust policy, be that a value in itself or a proxy for total welfare maximization. The EC also seems to aim at protecting consumers, at least according to some recent statements by Commissioner Monti, according to which 'the consumer is king' at the Commission[43].

If the competition authority adopts such a standard in the competitive assessment of a conglomerate merger, the merger will probably be authorized. Conglomerate mergers that bring about substantial efficiencies increase consumer welfare both in terms of lower prices and better product quality. Indeed, if the conglomerate merger creates substantial efficiencies, competitors will price more aggressively and the merged entity will be subject to increased competitive pressure. This ultimately implies that the efficiencies generated by the merger will be passed on to consumers.

3.1.1.2 Total welfare standard

On the other hand, the overall impact of a conglomerate merger on total welfare is definitely more ambiguous. In fact, consumers will benefit from the entry of a more efficient player in the market, and so will the merged entity itself. But competitors' profits will fall. The net result is however likely to be positive, at least in the short run.

3.1.1.3 Protecting competitors

On the other hand, if the competition authority seeks to protect competitors, it is quite straightforward to conclude that the merger will be blocked. Competitors will suffer higher pressure from the merged entity's more attractive product, and will experience a fall in their profitability. This might in the long run trigger exit on the side of competitors.

This analysis seems to support the view – recently expressed by the US antitrust authorities – that when the EC decided to block conglomerate mergers that brought about substantial efficiencies, such as *ATR/de Havilland* or *GE/Honeywell*, it was actually aiming at protecting competitors instead of competition[44]. As we will explain further in this paper, the EC's attitude towards conglomerate mergers that determine a loss of profitability on the side of the merged entity's competitors may be justified from the standpoint of economic theory, but only under rather restrictive conditions. If the EC's theory of competitive harm – which aims at protecting competitors as a proxy for protecting competition – is applied in circumstances that do not fulfill these conditions, then we may conclude that the EC approach is not based on sound economic theory.

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[43] See *supra,* note 5.

[44] See *supra,* note 3 and accompanying text.

3.2 A long-run competitive assessment

As we just explained, conglomerate mergers might create substantial efficiencies in the short run. Yet, in some cases, the emergence of a strong market player might jeopardize the existence of a sufficient number of competitors in the market, therefore allowing future abuses of market power. A dynamic competitive assessment implies that long-run effects are (to a certain extent) taken into due consideration. This is a very difficult task for economists: in conglomerate mergers, the outcome of a long-run consumer welfare standard will prove really ambiguous.

In what follows, we provide a description of the most relevant issues that arise in the assessment of the long-run impact of conglomerate mergers, in order to provide a checklist of the conditions that have to be fulfilled for a conglomerate merger to have a negative impact on consumer welfare in the long-run, thus justifying the EC concern that such mergers should be blocked.

Firstly, let us assume that the merged entity creates efficiencies, which are mostly related to efficient product tying. If this is the case, the first circumstance that should be ascertained is that competitors already in the market are not able to match the tie. Indeed, in most cases competitors could decide to produce a full range of products, therefore replicating the 'portfolio effects' that led the merged entity to gain a competitive advantage. Alternatively, competitors could decide to merge, in order to emulate the successful strategy followed by the merging parties. Yet, whenever competitors do not have a reasonable chance of matching the tie – in particular, because of their resource constraints – there is a chance that the conglomerate merger will ultimately determine a lessening of competition in the market.

Secondly, it is important to assess whether competitors who cannot match the successful tie-in will be ultimately triggered out of the market as a consequence of the merged entity's superior efficiency. This may happen whenever the conglomerate merger creates demand-side economies of scope, such as commonality savings (one-stop-shopping), which lead buyers to prefer purchasing their products from the conglomerate entity instead of dealing with other firms, selling less comprehensive portfolios. This is a kind of tie-in that might ultimately lead to a foreclosure of the market for less efficient competitors.

Thirdly, the 'efficiency offense doctrine' hinges on the assumption that the merged entity will raise its price above the competitive level once competitors have left the market. Such a conclusion is anyway far from straightforward. In order for the merged entity to be able to behave anticompetitively, some basic conditions should be met. As a matter of fact, if entry barriers are low, it will be hardly feasible, for the now-dominant merged firm, to charge supracompetitive prices without attracting entry by brand new entrants or re-entry by previous competitors. A requirement of high entry barriers typically implies that entrants face substantial specific investments (so-called 'sunk costs') or that incumbent players engage in long-run contractual relationships vis-à-vis upstream and downstream players. As we will explain further in Section 4, the EC tends to consider the availability of a wide portfolio of products as a barrier to entry[45].

Fourthly, the ability to raise prices remarkably depends on the absence of bargaining power on the side of buyers. In conglomerate mergers involving consumer goods, buyer power is normally enhanced whenever wholesalers or retailers are heavily concentrated: as is gradually acknowledged by antitrust practitioners, buyer power might significantly countervail the dominant seller's bargaining strength. Put differently, buyer power might prevent, to a certain extent, producers from appropriating surplus in the contractual arrangement with distributors.

The four conditions above are necessary but not sufficient for an 'efficiency offense doctrine' to be justified from the standpoint of economic theory. There is one last condition that should be fulfilled. Competition authorites, in assessing the long-run impact of efficient conglomerates, should engage in an intertemporal comparison of short-run efficiencies v. long-run inefficiencies. For such reason, future anticompetitive effects should not be too far ahead. The timing of future effects, as well as the discount rate applied to future reductions of consumer welfare, may prove decisive in the competitive assessment of a merger. As a matter of fact, the US and EU competition authorities remarkably disagree on the role of long-run efficiencies: on the one hand, as we already explained in Section 2.1, the US authorities give more weight to short-run effects, whereas the EC seems to attach more importance to long-run effects[46].

3.3 A checklist for the identification of anti-competitive mergers

The above considerations are quite hard to handle for a competition authority. Indeed, implementing an 'efficiency offense approach' requires that the authority engages in a great deal of empirical anlysis and economic

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[45] See *Guinness/Grand Metropolitan*, *supra* note 9, at §47.

[46] See *supra,* note 11 and accompanying text.

modeling and forecasting. Below, we provide a simple checklist which has to be taken into consideration by competition authorities in reviewing conglomerate mergers[47].

- The conglomerate merger must take place in oligopolistic markets where the merged firm enjoys substantial market power.
- Competitors must be unable to merge themselves or to reach production or marketing agreements that would allow them to offer a similar product line.
- Competitors also must be unable to compete profitably with shorter product lines than the conglomerate firm, and entry barriers must be high.
- Buyers must not have countervailing bargaining power.
- The benefits to consumers in the short-term – resulting from lower prices, or any other efficiency – must be relatively small when compared with the (uncertain) harm that they may suffer in the long run.[48]

As emerges quite clearly, the competitive assessment of conglomerate mergers under a long-run consumer welfare standard is highly complex. Conglomerate mergers might produce long-run inefficient outcomes under certain, rather specific circumstances. But they will not endanger consumer welfare in all other cases. Our ability to predict the future market developments is necessarily limited, as any reasonable economist would confirm. And the theory of competitive harm adopted by the EC would be viable only when it fits the facts of the case, i.e. when the merger takes place in a market in which all the abovementioned conditions are satisfied.

4. THE GUINNESS/GRAND METROPOLITAN CASE: IS THE COMMISSION REALLY GEARED TOWARD PROTECTING COMPETITORS?

The checklist developed in the last section, which helps devising the circumstances under which a conglomerate merger will be deemed anti-competitive under a long-run consumer welfare standard, is of great help in

[47] See Padilla, *The 'Efficiency Offense Doctrine' in European Merger Control*, IBA…(exact quote?).

[48] This depends *i.a.* on the rate at which we discount an uncertain future – which takes into account both an interest rate and the probability that the foreseen event will actually take place.

testing whether the EC's 'efficiency offense doctrine' is in fact geared toward protecting competitors, or is alternatively focused on the protection of consumers' interest in the long run.

There are not many examples of cases in which the EC assessed the competitive impact of a conglomerate merger involving consumer goods. One of the most relevant cases, from the standpoint of our analysis, is *Guinness/Grand Metropolitan*, which we analyze below[49].

In October 1997, the EC cleared the merger between Guinness and Grand Metropolitan, but only after imposing heavy conditions on the merged entity, such as ending the distribution agreement of Bacardi Rum in Greece, despite no market share overlap[50]. Both merging parties were producers of leading spirit brands in most national markets, and the proposed merger entity (*GMG*, later named *Diageo*) would have produced a wide portfolio of spirit brands in those markets. The EC considered each spirit (such as whisky, brandy, rum, gin, tequila, vodka and local spirits) as belonging to separate but closely related markets, and concluded that the merger would have created or strenghtened a dominant position in most cases, in particular in the supply of whisky but also in the supply of gin, rum and brandy.

In particular, for the Greek market, the EC conluded that the combined entity would cover all the major categories of spirits marketed in Greece, while none of its competitors could have matched such an integrated offer. The merged entity would become the driving force in the supply of whisky and would enjoy substantial market shares in gin (Gordon's), brandy (Metaxa) and rum (Bacardi)[51]. Figure 1 shows the market presence of the merged entities in Greece at the pre-merger stage, as well as the existence of competing brands. Other companies (Karoulias/Berry Brothers, Allied Domecq, Seagram) were present in fewer segments and often did not hold the leading brand. Moreover, according to the EC, competitors had no way to match the portfolio effects generated by the GMG merger. The merged entity would end up being four times as big as the next largest competitors[52].

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[49] Case no. IV/M.938, October 15, 1997.

[50] Other commitments filed by the merging parties were to divest the production of Dewar's and Anislie's Scotch Whisky brands in all national markets; to end Guinness' agency distribution agreement of Wyborowa vodka in Belgium/Luxembourg; "dispose of certain intrerests in Ireland in order to ensure continued competition in the distribution of spirits after the formation of GMG brands which otherwise would have effectively reduced the number of distributors in Ireland from four to two"; entrust the distribution of Gilbey's Gin to a third party distributor. *Id,* at §183.

[51] *Id.*, at §91.

[52] *Id.*, at §93.

Figure 1. GMG portfolio in the Greek market

Firm	Guinness	GrandMet	Others
Whiskey	X	X	X
Brandy		X	X
Rum	X		X
Gin	X		
Tequila		X	X
Vodka		X	X
Ouzo		X	X

4.1 The application of the 'Efficiency offense doctrine' in *Guinness:*

The main argument which inspired the EC's decision was the so-called theory of 'portfolio effects' or 'range effects', which implies that the merged entity enjoys stronger marketing opportunities arising from the availability of a wide portfolio of leading brands. The main efficiencies associated with the merger therefore stemmed from non-horizontal effects, consisting in demand economies of scope and cost synergies. Such efficiencies were considered by the Commission as raising competitive concerns: this supports the view that the EC actually applied an 'efficiency offense doctrine' in deciding the case. According to the Commission, "The holder of a portfolio of leading spirit brands may enjoy a number of advantages. In particular, ... he will be able to realize economies of scope and scale in his sales and marketing activities"[53].

The rationale adopted by the EC is as follows. Firstly, in the Commission's wording, "a wide portfolio of categories [would confer] major marketing advantages, giving GMG the possibility of bundling sales or increasing the sales volume of one category by tying it to the sale of another category"[54]. In other words, the availability of a wide range of products allows the merged

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[53] *Id.* at 40

[54] *Id.* at 100

entity to engage in strategic pricing vis à vis downstream distributors both in the HoReCa channel (so called 'on-trade') and in the Home distribution ('off-trade') channel, resulting in a foreclosure of the market to competitors. There were several ways in which the merged entity could have strengthened its market power:

a) *Full-line forcing:* the merged entity could have profitably bundled the sale of its spirit brands. Such an occurrence raises competitive concerns whenever firms produce leading brands, which retailers cannot "afford not to stock" (so-called *must-stock brands*)[55].

b) *Demand economies of scope/commonality savings*: the EC found that "the combined entity would be an attractive solution for one-stop shopping considerations"[56]. It was thought that the availability of a full-line of products would allegedly confer *GMG* a strong bargaining power vis-à-vis downstream distributors, thus making "the implicit (or explicit) threat of a refusal to supply more potent"[57].

c) *Price flexibility*: the Commission considered that the constitution of a broad portfolio of spirits would give the merged firm the flexibility to structure prices, promotions, and discounts and have a reasonably greater potential for product tying: "in contrast to the complete GMG portfolio, the discontinuity of the competitors' portfolios would deprive them of price flexibility and make them more vulnerable to market pressure."[58]

As a result, the EC found that the proposed merger would have created a player with disproportionate market power, and allegedly thought that the net effect on consumer welfare would be negative in the long run. The assessment was based on the finding that when elements of market power

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[55] *Id.* at 40

[56] *Id.* at 101

[57] *Id.* at 40.

[58] *Id.* at 103. In another decision, *Pernod Ricard/Diageo/Seagram* (Case No. COMP/M.2268, May 8, 2001), concerning a joint bid, made by Pernod Ricard and Diageo (the entity resulting from the *Guinness/Grand Metropolitan* merger, see *supra* Section 2.3), to purchase the Seagram spirits and wines business, the EC identified portfolio concerns stemming from the fact that: "Post-merger**,** if one or more additional leading brands are added to an existing range this may strengthen the overall position of the brand owner." *Id.*, §23. In the long term, welfare may be adversely affected when competitors are foreclosed, marginalized, or eliminated from the market and when the merged firm subsequently has the ability to raise prices, without fearing re-entry. "Greater portfolio diversity and the subsequent listing of the parties' weaker brands reduce the opportunities for competing suppliers whose products may be then de-listed by retailers." *Id.*, §24. In addition, according to the EC, whenever the merger brings about significant financial strength, the ability of the merged firm to cross-subsidize discounts across the complementary products in the product range may also come from profits made on products outside that range.

are combined, the whole might be greater than the sum of the parts, because portfolio effects allow profitable tying, bundling and flexible pricing solutions. Therefore, although individual leverage possibilities might have existed prior to the merger, the combined leverage possibilities post-merger, through product tying, became greater than the sum of the individual possibilities pre-merger. The EC therefore decided to authorize the merger subject to a number of heavy requirements, such as divesting the production or distribution of must-stock brands which would otherwise have granted excessive dominance to the merged entity[59].

The Guinness decision set out certain conditions under which a combined product portfolio may result in the creation or reinforcement of dominance. Interstingly, the Commission refers to portfolio effects as source of advantages that exert a potential effect on the *competitive structure* of the market. The strength of these advantages depends on a number of factors, which include[60]:

- Whether the holder of the portfolio has the brand leader or one or more leading brands in a particular market;
- The market shares of the various brands, particularly in relation to the shares of competitors;
- The relative importance of the individual markets in which the parties have significant shares and brands across the range of product markets in which the portfolio is held; and/or
- The number of markets in which the portfolio holder has a brand leader or leading brand.

Commento: Check whether this is entirely quoted

The ruling in *Guinness* strongly supports the view that the Commission actually developed a so-called 'efficiency offense doctrine'. In the short run, the merger would have unambiguously benefited consumers, in particular through lower prices and more aggressive competition. The conditions imposed by the EC aimed at depriving the merged entity of part of its competitive advantage over competitors – in other words, of its superior efficiency. From this viewpoint, the EC's decision seems to exhibit a pro-competior bias. We do not question whether such doctrine may be viable from the standpoint of economic analysis, at least in some circumstances. The problem lies in the extent to which the conditions for an economically

[59] See *supra* note 45.

[60] *Id.*, at §41.

sound application of the efficiency offense were fulfilled in this case. It is to this difficult task that we now turn.

4.1.1 Are the basic conditions for efficiency offense met in GMG?

As we explained, the ruling in *Guinness* seems to confirm that the EC is inspired by a pro-competitor bias. However, one might object that such a bias would vanish, once the long-run effects on consumer welfare are taken into account. While customers would have benefited in the short-term, they may end up being worse off in the long run as a result of higher prices.

Yet, in its decision, the Commission never addressed the issue of long-run consumer welfare. What's more, the EC did not even thoroughly address the issue of efficiencies conveyed to consumers by the transaction in the short run. To the contrary, the EC seemed to argue that the tying would only be beneficial for the merging firm, and that no efficiencies would be passed on to consumers. Such circumstance seems to support the view that the EC relied on a *structuralist* paradigm, aimed at preserving a sufficient number of competitors in the relevant markets. There is no trace of a long-run consumer welfare standard, even if we may guess that the Commission implicitly took the protection of competitors as a proxy for protecting consumer welfare.

The Commission considered the issue of portfolio effects as a means to raise barriers to entry in the market[61]. In doing so, the EC presumably took into account that the merger would trigger competitors' exit, and that the merged entity would profit from high barriers to entry, therefore remaining 'shielded from competitive pressure'[62].

The Commission also analyzed the issue of buyer power in the national markets, and concluded that both on-trade and off-trade customers could not exert such a countervailing power to limit the merged entity's freedom to set prices independently of competition. The existence of many must-stock brands in GMG's portfolio would lead retailers to a situation of economic dependency, in which they would be forced to buy GMG brands, even at supra-competitive prices.

In short, in the *Guinness* decision the EC did not carry out all the necessary analysis that was necessary in order to establish whether the merger would have sorted out beneficial, welfare-enhancing effects. The EC failed to appropriately assess the merger-specific efficiencies that would have been

[61] *Id., at 47.*

[62] *Id., at 99.*

passed on to consumers both in the short and in the long run. We reckon that such a task would have implied a remarkable amount of economic analysis, in order to forecast the probability of competitors' exit from the market, assess whether the merged entity would remain shielded from competitive pressure, and find out whether the demand elasticity would allow a dominant conglomerate to exploit its market power by charging supracompetitive prices.

In particular, the EC's decision completely disregarded the benefits to consumers resulting from reduced transaction costs (i.e., one-stop-shopping) and lower prices in the short term. As in some other EC rulings on conglomerate mergers[63], the EC seemed to consider these allocative efficiencies as "strategic" and short-lived, and therefore not important enough to offset the long-term damage to competition created by the potential exclusion of competitors. This reasoning is contrary to sound economic analysis[64].

The EC approach to conglomerate mergers that bring about substantial efficiencies, as emerges from *Guinness/Grand Metropolitan*, is rather puzzling. While it is true that the EC has shown increasing interest for the evaluation of efficiencies in the competitive assessment of mergers after *Guinness*, the decision at stake left many points of contention, which are still subject to discussion, as we will explain below, in the concluding section of this paper.

5. CONCLUDING REMARKS

The EC's approach to conglomerate mergers between producers of competing, complementary goods has been criticized on several grounds. In this paper, we focused on the economic flaws that have been pointed out on both sides of the Atlantic. Some commentators argued that the EC's approach is geared toward protecting competitors instead of competition, a finding which evocates a famous sentence from the Warren Court's *obiter dicta* in *Brown Shoe*[65]. Others say that it is based on a misconceived understanding of the economics of complementary goods. In our opinion, neither of these criticisms is justified.

[63] See *ATR/de Havilland*, *supra* note 8. For a complete discussion of this transaction, see Paul D. Klemperer and A. Jorge Padilla, *Do Firm's Product Lines Include Too Many Varieties?*, RAND Journal of Economics, Vol. 28, 1997..

[64] See Padilla, *supra* note 47.

[65] *Brown Shoe Co. v. US*, 370 U.S. 294 (1962)

A pro-competitor bias does not belong to the répertoire of EC merger control. The EC's overarching goal is to protect consumer welfare, as Commissioner Monti recently reaffirmed. Indeed, the EC rulings are increasingly based on logically consistent economic theories. Yet, in many instances these theories rely on highly speculative predictions, whose economic grounds are shaky at best.

European competition policy is traditionally linked to a more structuralist approach, which closely ressembles the pre-Chicago approach adopted by the US antitrust authorities before the enactment of the 1982 Merger Guidelines – an approach whose theoretical underpinnings may be traced back to the Structure-Conduct-Performance paradigm developed by the Harvard School back in the late 1930s[66].

Such an approach must not necessarily be jettisoned, nor constitutes an isolated experience in the panorama of contemporary antitrust. As a matter of fact, the so-called Post-Chicago economists expressed weaker faith in the redeeming virtues of market forces, and showed that in some cases practices such as tying and leverage may determine a reduction of competition in the relevant market[67]. Furthermore, the question of pricing behavior by dominant firms is still subject to conflicting opinions. Recent literature has proposed to ban above-cost predatory pricing by large incumbent firms, highlighting an approach that closely mirrors the efficiency offense doctrine[68].

A relevant strand of economic literature supports the emphasis on market structure exhibited by EU competition policy. According to some commentators, the roots of structuralism in EC competition policy are also to be found in the Ordoliberalist School of economic thought that inspired and permeated the establishment of the Community[69]. Other, authoritative scholars such as Italian economist Franco Romani confirmed that, if compared with its US counterparts, the EC exhibits only a limited faith in

66 See E.S. Mason. (1939) *Price and Production Policies of Large-Scale Enter-prise*, American Economic Review 29: 61–74; the structure-conduct-performance paradigm was later formalized by J.S. Bain, (1956) *Barriers to New Competition*. Cambridge, Mass: Harvard University Press. For an overview of the US early caselaw on conglomerate mergers, see *supra*, Section 2.1.

67 See e.g. Micheal D. Whinston, *Tying, Foreclosure and Exclusion*, 80 Am. Econ. Rev. 837 (1990), and Dennis Carlton & Michael Waldman, *The Strategic Use of Tying to Preserve and Create Market Power in Evolving Industries*, NBER Working Paper No. 6831 (1998).

68 See Edlin, *supra* note 27.

69 The Freiburg-based Ordoliberalist school was founded by the German economist Walter Eucken and by a lawyer, Franz Böhm. Interstingly, such theory was long ignored in the US, despite the fact that Eucken had co-founded (in 1947) the Societé Mont Pélérin together with, *inter alios*, Milton Friedman, George Stigler and Aaron Director, which inspired the Chicago School of Law and Economics.

the taumaturgical virtues of 'competition on the merits'[70]. This, according to Romani, depends on a peculiar feature of the European economic history: political decisions, more than "superior skills, foresight and industry" allowed large firms to achieve dominance in most markets[71]. This limited faith in market meritocracy supports the structuralist view endorsed by the EC in its rulings on conglomerate mergers[72].

Today, the EC seems somewhat shaking between the need to approach the US standards of competition policy, and the need to preserve its traditional economic approach. The EC recently showed a stronger interest for the assessment of efficiencies resulting from a merger. Starting from the 1998 Notice on the Merger Regulation[73], the EC specified that productive efficiencies (such as technical progress) must be appraised in line with the principles set out in article 85.3 (now 81.3) of the EC Treaty (thus, as an element to be considered in the competitive assessment). Secondly, in the 2001 Green Paper on the Review of the Merger Regulation[74], the EC clearly stated its availability to consider "the extent to which" the production of efficiencies will lead to clearing a merger. Finally, the recent Commission's Notice on the Appraisal of Horizontal Mergers specifies that "as a consequence of the efficiencies that the merger brings about, this merger does not create or strengthen a dominant position *as a result of which* effective competition would be significantly impeded[75]. This will be the case when the efficiencies generated by the merger are likely to enhance the incentive of the merged entity *to act pro-competitively* for the benefit of consumers, by counteracting the effects on competition which the merger might otherwise have"[76].

As a consequence, efficiencies will be taken into consideration only when they lead the merged entity to 'act pro-competitively': this, according to the

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[70] See Franco Romani's speech at the Seminar *Towards an International Antitrust Law: Comparing US and EU Approaches*, Rome, December 10, 2001, re-published as George Priest & Franco Romani, *L'antitrust negli Stati Uniti e in Europa. Analisi e Psicoanalisi di una Divergenza*, Mercato Concorrenza Regole, no. 1/2002.

[71] We refer to the statement of Judge Learned Hand in *United States v. Aluminum Company of America,* 148 F.2d 416, 430 (1945).

[72] Recall that the EC competition law prescribes that the dominant firm has a 'special obligation' vis-à-vis other players in the market, which has no omologous in the US antitrust law.

[73] Notes on Council Regulation (EEC) 4064/89, Published in "*Merger control law in the European Union*", European Commission, Brussels-Luxembourg, 1998 (Also available at http://europa.eu.int/comm. /competition/mergers/legislation/regulation/notes.html.

[74]See the Green Paper on the Review of Council Regulation (EEC) No 4064/89, *COM (2001) 745/6 - 11.12.2001*

[75] See *Commission Notice on the Appraisal of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings*, December 11, 2002.

[76] *Id.*, at §88 (Emphasis added)

Notice[77], is measured by two parameters: a) that the merged entity makes continuing efforts to enhance efficiencies; and b) that sufficient competitive pressure are exerted *from the remaining firms and from potential entry*"[78].

Such wording recalls the EC's intimate conflict between the *ex post* approach adopted in the US, which implies a wider acknowledgement of merger-specific efficiencies, and the *ex ante,* structuralist approach, aimed at preserving a sufficiently competitive market structure as a proxy for the protection of long-run consumer welfare. On the one hand, since the merged entity is required to exert 'continuing efforts' to enhance efficiencies, it is hard to imagine how an *ex ante* approach could ever capture the future commitment of the combined entity to avoid abusive conduct and x-inefficiencies. On the other hand, the emphasis on 'remaining firms' is more consistent with a structuralist approach, as the preservation of a sufficiently competitive market structure emerges as a necessary condition for the merged entity to keep behaving competitively in the long run.

In light of the profound differences observed between the US and the EU approaches to the review of conglomerate mergers, we argued that economic theory might constitute a useful 'litmus paper' for detecting those rulings that pursue the enhancement of consumer welfare in the long run, and those who are based on tentative, speculative theories. The major points of contention that stem from the analysis of the EC's caselaw on conglomerate mergers involving consumer goods are listed below.

A first point of contention is that the EC decisions strongly rely on rather hazardous predictions on competitors' exit from the market as a result of a conglomerate merger whose effect is to create a more efficient player. Foreseeing market evolution is a highly complex task for economists, and the exit of competitors would be likely only under certain, rather restrictive circumstances.

Another criticism that might be addressed to the current EC approach is its negative attitude towards efficiency defenses, which will presumably be mitigated after the reform of the merger regulation. According to Commissioner Monti, the EC distinguishes "clearly between (…) mergers leading to price reductions that are the result of strategic behavior on the part of a dominant firm, the purpose of which is to eliminate or marginalize competitors with a view to exploiting consumers in the medium term and (…) mergers which will objectively

[77] *Id.*

[78] *Id.* (Emphasis added)

lead to significant and durable efficiency gains that are likely to be passed on to consumers".

The EC caselaw does not entirely support this view. The EC usually does not analyze whether the merged entity will actually have an incentive to raise prices or decrease product quality post-merger; this strongly depends on the peculiar features of the market under scrutiny – e.g., price elasticity, demand-side and supply-side economies of scale and scope, market contextability. Economic theory predicts that even a monopolist will pass on efficiencies to a certain extent, since the price will always fall as a result of lower marginal costs. The EC seems also unwilling to perform a serious intertemporal trade-off between the short-run and the long-run effects of a merger. The timing and discounting of future inefficiencies is of utmost importance in the competitive assessment of a merger.

Moreover, there seems to be no reliable criterion for distinguishing between allocative and productive efficiencies, by assuming that the latter will be the only positive effects considered in the competitive evaluation of a merger. Efficiencies are to be considered as long as they exert positive influence on consumer welfare, not on the basis of their nature.

Finally, there is a desperate need for more detailed and rigorous factual anlyses in European merger control – hard evidence regarding market outcomes must be developed to test the EC's theories of competitive harm. Knowing what is right in merger appraisal requires a detailed inquiry into the facts of the case, a review of all existing evidence, and in some cases, the use of statistical methods to develop a better understanding of the markets under scrutiny.

As a conclusion, the debate on the EC approach to merger control is far from reaching the last word. In this paper, we assumed that the EC aims at protecting consumers in the long run. Yet, instead of questioning the intentions, we look at the results, and the results are not particularly convincing. Even the road to hell, as everyone knows, is full of good intentions. And the road to sound competition policy, as a matter of fact, isn't less tricky.