

EU Merger Review Policy: An Increasing Role for Third Parties?

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INTRODUCTION

The state of competition policy in the European Union is truly at a crossroads.¹ High profile cases have emerged that have brought many legal issues before the European Commission (“Commission”) and European Court of Justice (ECJ). There have been two recent cases that highlight the growing problems for competition regulators.

In September 2005, Spain’s Gas Natural attempted a hostile takeover bid for the Spanish electricity giant Endesa, a merger that was later blocked by the Spanish antitrust court. The Commission declined to intervene in the case because the two companies did not record more than one-third of European turnover outside Spain. Later, in February 2006, German energy company E.ON proposed a series of bids for Endesa. In order to protect Spanish energy interests, Spain imposed a series of conditions on E.ON in the merger deal, conditions that appeared entirely within Spanish nationalist concerns to protect energy interests from international influence. This time, the Commission was forced to intervene because the conditions were not harmonious to the internal market. Ultimately, the Commission decided the conditions as illegal and is presently taking the Spanish government to the ECJ because it refused to lift conditions even after revisions. This case raises serious questions of national interest and to what extent the Commission has regulatory competence above member state governments.

The second case, which will be the focus of this brief, questions the legal issues surrounding substate actors in mergers. Sony Music and BMG announced a merger deal

¹ This policy brief is adapted from my thesis on EU Merger Review Policy. The thesis discusses the theoretical and empirical development of merger review policy and argues that EU merger review today has greatly departed from its original neofunctionalist foundations.

in November 2003. The Commission approved the merger in June 2004, but soon after, a group of third parties took the Commission to the European Court of First Instance (CFI). The third parties were represented by an organization known as Impala, a collection of 25,000 independent music producers. In response to third party arguments, the court nullified the merger in July 2006. The Impala case is one of a growing number of increased scrutiny by the courts to evaluate the Commission. It also presents a unique opportunity for third party intervention in the merger review process.

This brief will address the increasing role for third party, substate actors in the merger review process. And as the European Courts expand their role in competition law review, it presents a new set of strategies for third parties. This brief will address the basic question: what is third party strategy in merger review? It will expand on this question using a game theory analysis to determine when third party intervention is the best strategy. I argue that given the more vigorous judicial review of mergers by European Courts, intervention among the European Courts, *not* the Commission, is the best strategy for third parties.

LEGAL ANALYSIS

The Sony Music and BMG merger (“Sony/BMG case”) was declared compatible on July 19, 2004. Although the merger occurred after the enactment of Council Regulation No. 139/2004 (“2004 Regulation,” the first significant amendment of EU merger control policy in 15 years), the case was decided on rules established in accordance with Council Regulation No. 4064/89 (“1989 regulation”) pursuant to Article 26(2) of the 2004 Regulation.

The 1989 Regulation and 2004 Regulation did not differ on the legal rights of parties and third persons in merger review. What has changed, at least in substantive terms, is the test for competition. The 1989 Regulation test provided that “a concentration which creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it shall be declared to be incompatible with the common market.”² Debate arose as to the specificity of this “dominance test” and whether the test should be expanded to address concentrations in markets even where there was no dominance and no tacit coordination.

In response to pleas of academics, Member States and some regulators, the Commission adopted a broader formulation in Article 2 of the 2004 Regulation. All else being equal, a broader test of concentration would broaden the scope of possible arguments by third parties and cases in which they could intervene. It is the 2004 regulation that has increased the role of third parties.

Aditi Bagchi writes in “The Political Economy of Merger Regulation” of the relationship between competition policy and economic theory. Bagchi contends that European regulators care little of consumer interests and rather focus their efforts on the effect on competitors. This forces a role change for third parties representing consumer interests. He further identifies the vagueness in EU merger regulations that “indirectly expands the enforcement authority of the Commission.”³

Another legal scholar, Keith Fisher, writes in “Transparency in Global Merger Review: A Limited Role for the WTO?” about issues parties in transnational merger and

² EC Regulation 4064/89, Article 2(3).

³ *Ibid.* Page 5.

acquisition transactions must face. Part of his thesis points to the effectiveness of the strategic planning phase. There is an important difference, for Fisher, between EU and US competition authority. Both share the important leverage of pre-merger notification, granting them “leeway to negotiate with the parties and discretion to craft solutions to competitive concerns.”⁴ Yet, the Commission lacks adjudication and EU *ex post* merger analysis, coupled with fear of regulatory lag, further increases the importance of strategic planning phase negotiations, and in the context of EU merger regulations, the importance of Phase I review.

IMPORTANCE OF THIRD PARTY INTERVENTION

Focusing solely on third party intervention, the field of conflict studies may provide a starting point in developing assumptions. Kevin Siqueira writes about various scenarios for third party intervention in “Conflict and Third-Party Intervention.” He evaluates various scenarios of possible concern for third parties to intervene when two factions (government and a rebel or opposition movement) are in conflict and “act strategically against one another.”⁵ Third-party intervention can be either neutral or choosing a side, supporting one party at the expense of another. Siqueira notes that both direct and indirect effects of third party intervention must be taken into consideration and the analysis will change depending how much information the parties know.

Another application from which we can take a step closer to third party intervention in merger review comes from Paola Manzini and Clara Ponsati in their paper “Stakeholder Bargaining Games.” The role of third parties is defined by their stakeholder

⁴ Fisher, K. (2006). Transparency in Global Merger Review: A Limited Role for the WTO? *Stanford Journal of Law, Business & Finance*. Vol. 11. Page 2.

⁵ Siqueira, K. (2003). Conflict and Third Party Intervention. *Defence and Peace Economics*. Vol. 14 Num. 6. Page 389.

interest as it relates to bargaining between two parties. They posit two distinctions of stakeholder bargaining games from trilateral negotiations: (1) the liquidity constraint, the stakeholder (third party) may transfer a share of the benefits to the bargaining parties, but does not share in the surplus, and (2) participation is not assured in every period of the negotiations.⁶ One point made in their analysis is that when stakeholder participation is uncertain, inefficiencies arise.

We can take the two analyses and draw two main points for our own analysis: First, the knowledge of information is important for all parties, including third parties. Second, inefficiencies arise when third party participation is uncertain, increasing the importance of third party involvement.

ANALYSIS

We begin our analysis with three assumptions: (1) there is a legal framework in the EU for third party participation in merger review and has been held constant through the 2004 regulation. (2) Information is known, due to pre-merger notification, of intents of the merging parties and intents of the third parties, but information is not known about the intents of the Commission. (3) There are two phases to EU merger review, Phase I and Phase II. The distinction is made by the decision of the Commission to approve or block the merger at the end of Phase I.

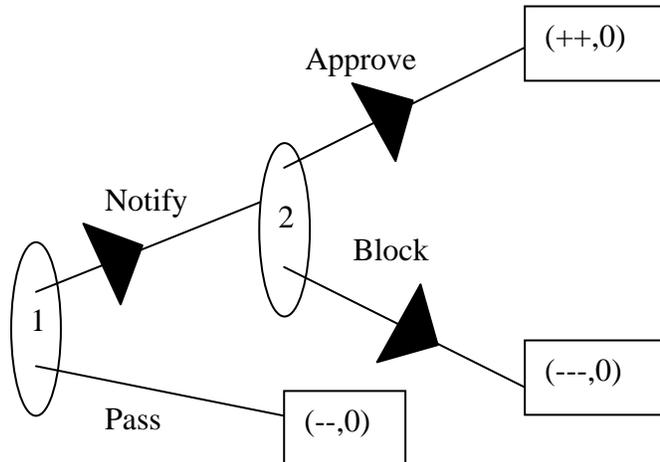
This analysis will use three players: “Merging Parties,” “Third Parties,” and “European Commission.” The Merging Parties will have the options to notify or pass during Phase I and the options to “Hard Push,” “Light Push,” or “Pass” during Phase II. The Third Parties will have the options to “Intervene” or “Pass” during Phase II. The

⁶ Manzini, P. and Ponsati, C. (2006). Stakeholder Bargaining Games. *International Journal of Game Theory*. Vol. 34. Page 68.

European Commission will have the options to “Approve” or “Block” during both Phases.

Figure 1: Phase I Merger Review

1 = Merging Parties
2 = European Commission



We begin our analysis with an extended form of our Phase I game. The payoffs have been simplified using finite values of “+”, “-“, or “0”. During Phase I, the Commission can make many decisions, pursuant to Article 6(1). For our simplified analysis, an Approve signifies the Commission has decided that the concentration is within the scope of the 2004 Regulation and not in breach of substantive criteria. A Block signifies the Commission has decided the concentration is within the scope of the 2004 Regulation but is incompatible with the common market, and they enter Phase II. This decision must be made in 25 working days of notification. There are fines levied against merging parties who do not notify the Commission, hence the negative payoffs for Merging Parties who decide to Pass. In our analysis, there is no difference in strategy

for the Commission whether to Approve or Block the merger as they must devote the same amount of resources in their decision and must act impartially to any outcome. The payoffs for Merging Parties are greatest with a Commission Approve as they do not have to invest resources in a Phase II investigation. Using backward induction, we find that the best strategy is for the Merging Parties to Notify the Commission.

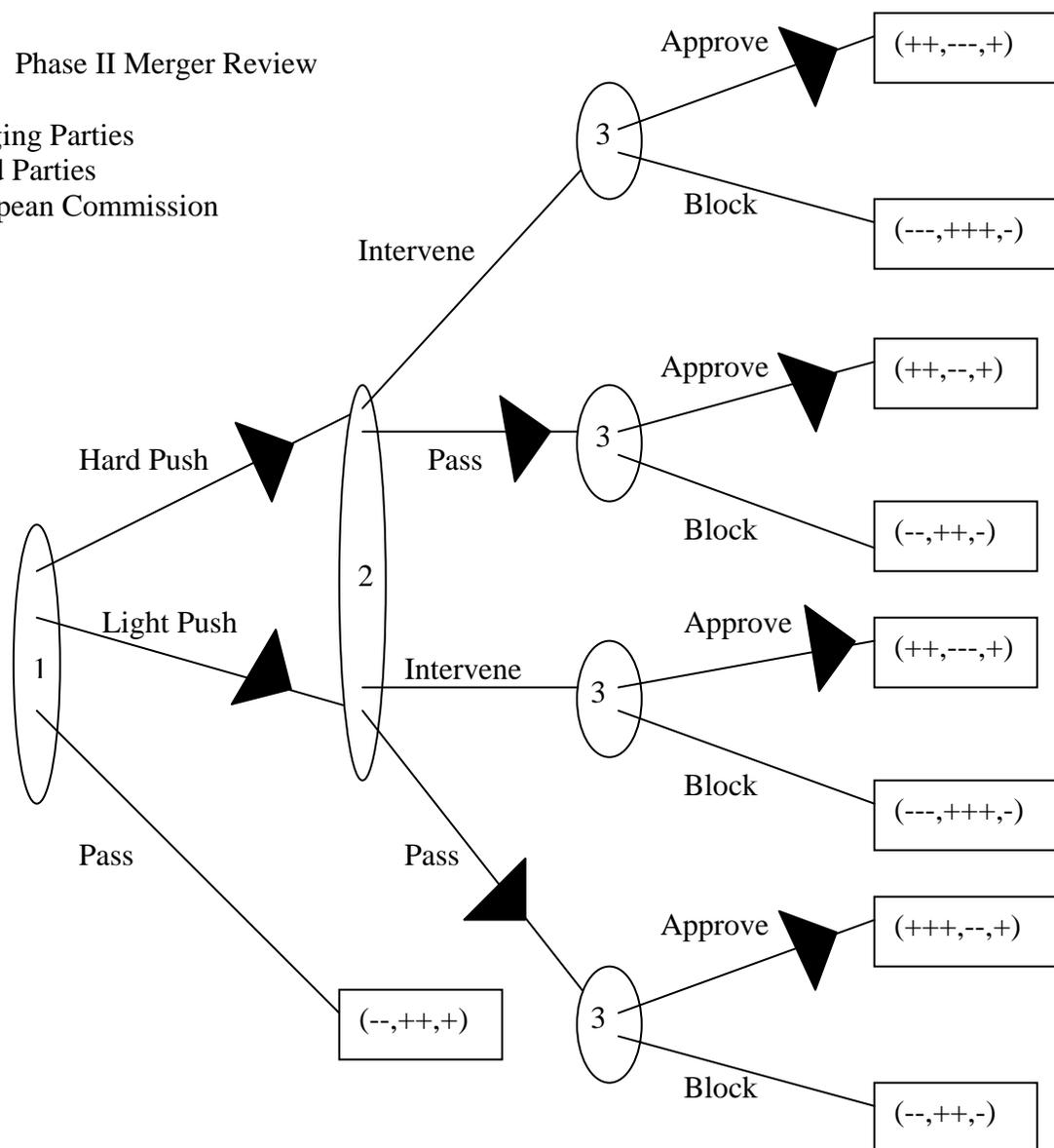
The next step in our analysis is to introduce the Third Parties during Phase II merger review. While Third Parties may be called on by the Commission during Phase I investigation, they play an advisory role, and generally do not enjoy payoffs or risks. It is prudent at this juncture to reintroduce the Sony/BMG merger approved by the Commission in 2004. The third parties chose to wait post-approval to intervene directly with the courts. Our analysis will present their best strategies had they intervened during Phase II investigation.

During Phase II investigation, the Merging Parties may make a Hard Push or Light Push to the Commission. A Hard Push may involve spending large amounts of resources to present expert testimony, legal expertise, or lobbying efforts. A Light Push would include use of similar resources, but far less than a Hard Push. The Third Parties are assumed, as in the case of the Sony/BMG merger, to have strong preferences on the outcome and will use all available resources when choosing to intervene, understanding the risks and benefits. The increased payoff for a Commission Approve compared to a Commission Block is due to two factors: (1) the intangible public pressure factor to avoid appearing uncompromising, and (2), maintaining the “status quo” of overwhelming approval of Phase II mergers (approximately 70%).⁷

⁷ European Commission. “European Merger Control – Council Regulation 139/2004 – Statistics.” April 30, 2007. Available at <http://ec.europa.eu/competition>.

Figure 2: Phase II Merger Review

1 = Merging Parties
 2 = Third Parties
 3 = European Commission



Using backward induction, we observe the Merging Parties best strategies are for either a Hard Push or a Light Push and the Commission should always Approve. What is most interesting is the best strategy for Third Parties during Phase II merger review is to Pass. This strategy would be altered by a reduction in the payoffs for the Commission to Approve. Such a reduction could come in the form of increased roles for the European Courts, relieving the Commission of the public pressure factor to compromise.

CONCLUSION AND RECOMMENDATIONS

This analysis seems to confirm the two points discussed in analysis of two legal articles. The first point is that EU merger regulation is vague, increasing Commission authority. This is coupled with a second point that merger decisions are not adjudicated in the EU, further increasing the importance of the Commission in merger review. Furthermore, there is evidence to support Fisher's argument for the importance of Phase I negotiations. Because the Commission has no best strategy, its analysis should be more fair and unbiased than Phase II review.

This brief began with the argument that given the more vigorous judicial review of mergers by European Courts, intervention among the European Courts, *not* the Commission, is always the best strategy for third parties. Our analysis confirms this argument, that intervention outside an adjudicated setting (Phase I and II merger review) is *not* the best strategy. The role of the Courts greatly reduces the vague nature of EU merger regulation, as their decisions are based on interpretation of the law. This changes the role and influence of the Commission and ultimately the outcome of our analysis.

To solve the recent crises in EU competition policy and merger review, the EU must: (1) continue to increase the specificity of EU merger regulations, as the 2004 Regulation did not go far enough in establishing concrete roles for the Commission, merging parties, and third parties; and (2) increase the role of the courts in merger review, similar to the adjudication powers of the US Department of Justice and Federal Trade Commission, thereby increasing the role for third parties.