**The role of market shares and market concentration indices in the European Commission's Guidelines on the assessment of horizontal mergers under the EC Merger Regulation.**

Comments prepared by Vincent Verouden, Ph.D.
European Commission, DG Competition, Brussels*.

FTC and U.S. DOJ Merger Enforcement Workshop,
Washington, DC, February 17-19, 2004.

## I. Introduction

On 20 January 2004, the Council of the European Union adopted Regulation (EC) No 139/2004 on the control of concentrations between undertakings (the "EC Merger Regulation").[1] It is to replace the existing Merger Regulation, Council Regulation (EEC) No 4064/89 of 21 December 1989.[2] The new Regulation will be applicable as of 1 May 2004, to operations that have been finalised on or after that day.

In parallel, the European Commission adopted its Notice ("Guidelines") on the assessment of horizontal mergers under the EC Merger Regulation. These Guidelines complement the changes to the Merger Regulation and will become applicable as of 1 May 2004, together with the new Regulation. In particular, the Guidelines complement the re-wording of the Merger Regulation's substantive test for reviewing mergers. The new Regulation requires intervention in relation to mergers which "would significantly impede effective competition, in particular as a result of the creation or strengthening of a dominant position" in the markets concerned.[3]

---

* The views expressed in this submission are those of the author and do not necessarily reflect those of the European Commission.

1 Council Regulation (EC) No 139/2004 of 20 January 2004 (OJ L 24, 29.01.2004, p.1). The Regulation applies to all concentrations having a Community dimension, as defined on the basis of the annual turnover of the companies concerned and confers exclusive jurisdiction to the Commission for such cases. The Council of Ministers is the legislative body representing the Member States of the European Union.

2 Council Regulation (EEC) No 4064/89 of 21 December 1989 (OJ L 395, 30.12.1989, p.1; corrected version OJ L 257, 21.9.1990, p. 13), as amended by Council Regulation (EC) No 1310/97 of 30 June 1997 (OJ L 180, 9.7.1997, p.1; corrigendum in OJ L 40, 13.2.1998, p. 17).

3 According to the existing Merger Regulation (EEC) No 4064/89 a merger is to be prohibited if it "creates or strengthens a dominant position as a result of which effective competition would be significantly impeded". The wording of the test was changed to make clear that the test also covers cases where the merging firms would be in a position to raise prices, and thus exercise

## II. The EU Merger Guidelines

In its Merger Guidelines, the Commission sets out the analytical approach it takes in assessing the likely competitive impact of mergers[4] between competing firms (so-called horizontal mergers). The adoption of these Guidelines is the result of a process that started in December 2002 with the publication of a Draft Notice for the purpose of public consultation.

The Guidelines make it clear that mergers must be assessed with a view to determining whether or not they enhance the market power of companies in a manner which is likely to have adverse consequences for consumers, notably in the form of higher prices, poorer quality products, or reduced choice.[5]

In this regard, the Guidelines explain that there are two main ways in which horizontal mergers may significantly impede effective competition: by eliminating important competitive constraints on one or more firms, which consequently would have increased market power ("non-coordinated/unilateral effects"), or because it makes anti-competitive coordination between the remaining firms more likely or more effective ("coordinated effects").[6]

Non-coordinated effects may arise, in particular, when the merger leads to a dominant position for the new entity, i.e. to "a situation where one or more undertakings wield economic power which would enable them to prevent effective competition from being maintained in the relevant market by giving them the opportunity to act to a considerable extent independently of their competitors, their customers and, ultimately, of consumers" (the definition of dominance given by the European Court of First Instance).[7] Typically, a dominant firm has an appreciably larger market share than the next competitor post-merger,[8] but this is by no means the determining or only characteristic.

The Guidelines outline a number of factors, which taken separately are not necessarily determinative, which may influence whether significant non-coordinated effects are

significant market power, without necessarily being "dominant" in a way hitherto recognised by the European Courts (e.g., not being the company with the largest market share). For more details, see Vincent Verouden, Claes Bengtsson and Svend Albaek, *The Draft EU Notice on Horizontal Mergers: A Further Step in Convergence,* forthcoming in The Antitrust Bulletin, Spring 2004.

4 As in the EU Guidelines, the term "merger" is used here as a synonym for the broader term "concentration" used in the EC Merger Regulation.

5 Guidelines, ¶ 8. By "increased market power" is meant the ability of one or more firms to profitably increase prices, reduce output, choice or quality of goods and services, diminish innovation, or otherwise influence parameters of competition.

6 Guidelines, ¶ 22.

7 Guidelines, ¶ 2. Case T-102/96, Gencor v Commission, [1999] ECR II-753, paragraph 200.

8 Guidelines, ¶ 25.

likely to result from a merger.[9] Not all of the factors need to be present for non-co-ordinated effects to be likely, nor should it be considered an exhaustive list:

- Merging firms have large market shares;
- Merging firms are close competitors;
- Customers have limited possibilities of switching supplier;
- Competitors are unlikely to increase supply if prices increase;
- Merged entity able to hinder expansion by competitors;
- Merger eliminates an important competitive force.

The scenario of co-ordinated effects is traditionally also referred to as "collective dominance".[10] The corresponding subsection in the Guidelines specifies that coordination is more likely to emerge in markets where it is relatively simple to reach a common understanding on the terms of coordination. Furthermore, three conditions are necessary for coordination to be sustainable. First, the coordinating firms must be able to monitor to a sufficient degree whether the terms of coordination are being adhered to. Second, discipline requires that there is some form of credible deterrent mechanism that can be activated if deviation is detected. Third, the reactions of outsiders, such as current and future competitors not participating in the coordination, as well as customers, should not be able to jeopardise the results expected from the coordination.

The remaining sections of the Guidelines describe a number of countervailing factors to an increase in market power resulting from the merger. These are, respectively, the likelihood that buyer power would act as a countervailing factor to an increase in market power,[11] the likelihood that entry would maintain effective competition in the relevant markets,[12] the likelihood that efficiencies would act as a factor counteracting the harmful effects on competition which might otherwise result from the merger,[13] and the possibility of a failing firm defence.[14]

## III. Market share and HHI indices in the Guidelines

Market shares and the overall level of concentration in a market normally give useful first information about the competitive situation in a market. The Guidelines therefore indicate, in Section III of the Guidelines, specific market share and concentration levels to specify in which situations the Commission is likely or not likely to have competition concerns. Section III of the Guidelines is reproduced in the annex to this paper.

---

[9] Guidelines, ¶¶ 26 – 38.
[10] Guidelines, ¶¶ 39 - 57.
[11] Guidelines, ¶¶ 64 - 67.
[12] Guidelines, ¶¶ 68 - 75.
[13] Guidelines, ¶¶ 76 - 88.
[14] Guidelines, ¶¶ 89 - 91.

*Market shares*

The Guidelines specify that according to well-established case law, very large market shares - 50% or more - may be in themselves evidence of the existence of a dominant market position.[15] It is further noted that the Commission has, in certain past cases, also considered mergers resulting in firms holding market shares between 40% and 50%, and in some cases below 40%, to lead to the creation or the strengthening of a dominant position.[16]

Certain mergers, by reason of the limited market share of the companies concerned, are not likely to significantly impede effective competition. An indication to this effect exists, in particular, where the combined market share of the merging firms does not exceed 25%. This indication derives from Recital 32 of the EC Merger Regulation.[17] However, it does not apply to cases where the proposed merger is likely to give rise to co-ordinated effects.[18]

*HHI*

To complement the above indicia, the Guidelines also apply the Herfindahl-Hirschman Index ("HHI"), and the change in the HHI from pre-merger to post-merger ("delta") as first indications of the change in competitive pressure in the market following the merger.

The Guidelines indicate that the Commission is unlikely to identify competition concerns in a market with a post-merger HHI below 1000, and that such cases normally do not require extensive analysis.[19]

The Commission is also unlikely to identify competition concerns in a merger

- with a post-merger HHI between 1000 and 2000 and a delta below 250,

- with a post-merger HHI above 2000 and a delta below 150

except where some special circumstances are present, which somehow invalidate the HHI as a useful proxy for the change in competitive conditions.[20] This may relate, by way of example, to the following instances: (a) a merger involves a potential entrant, or

15 Guidelines, ¶ 17. It is a distinct question whether a dominant position is created or strengthened as a result of the merger.

16 *Id.*

17 European Union legislation is generally prefaced by a series of so-called "recitals" which seek to place the subsequent operative legal provisions in their proper context, and which serve as an indicator of the legislator's intent.

18 Guidelines, ¶ 18.

19 Guidelines, ¶ 19.

20 Guidelines, ¶ 20.

a recent entrant with a small market share; (b) one or more merging parties are important innovators in ways not reflected in market shares; (c) there are significant cross-shareholdings among the market participants; (d) one of the merging firms is a maverick firm with a high likelihood of disrupting coordinated conduct; (e) indications of past or ongoing coordination, or facilitating practices, are present; (f) one of the merging parties has a pre-merger market share of 50% or more.

The HHI indices accordingly give a useful indication to the parties to the merger as to when a merger is unlikely to cause concerns. They do not give rise to a presumption of either the existence or the absence of such concerns.

*Discussion*

The main purpose of giving market share and concentration levels specifying in which situations the Commission is not likely to have competitive concerns and in which situations it may have such concerns, is to improve the predictability of the enforcement system for prospective users.

One important question will always be, of course, where to put the indicative levels. Ideally, the thresholds should provide the business community with clear guidance as to which type of transactions would be likely to raise concerns and which would not. But it is important to keep in mind that market shares and concentration levels only provide part of the picture and that many other factors have to be considered in an in-depth assessment of a transaction. To illustrate how difficult the exercise is, one can imagine a transaction that would be a straightforward clearance because entry is easy, buyers are strong, and alternatives outside the relevant market are easily available. But one could also imagine another context in which a transaction that would lead to exactly the same outcome in terms of market shares would be challenged because entry is impossible, demand elasticity is low, buyers are fragmented etc.

As regards the specific market share levels (e.g., the 25% and 50% benchmarks), the Commission naturally chose to adopt the indications given by the European Courts as regards the concept of dominance. As the concept of dominance will continue to play a central role in EU merger control, the indications of the Courts continue to be relevant.

In the context of the HHI levels, neither the Commission nor the Courts have used the HHI index or the delta on a systematic basis in their substantive assessments of mergers. To gain insight into the levels actually applied, the Commission made an analysis of a large number of its past decisions, and compiled the information given about the market shares of participants on the relevant markets. On this basis, it calculated the HHI and the delta. The analysis was carried out for the following sets of cases: (a) all cases where the Commission established dominance;[21] (b) all cases where the Commission

[21] Art. 8(3) prohibition decisions and Art. 8(2) clearance decisions with remedies.

accepted remedies in Phase I on the basis of serious doubts;[22] (c) all Phase I clearance cases in the year 2002.[23] In total, the analysis was based on data from 1231 markets from 207 cases[24].

In broad terms, the analysis confirmed that it would be difficult to find any set of HHI levels and deltas that would provide for a clear and informative distinction between cases in which the Commission is not likely to have competitive concerns and situations in which it may have such concerns. However, a further analysis of those cases where the Commission identified competition concerns, but where either the HHI or the delta were not particularly high, revealed that typically one or several "special circumstances" could be identified that made the particular estimate for the market share, and consequently, the HHI and the delta not very informative. Common examples were cases where one of the merging parties was a recent entrant, or where a large - often very large and already dominant - firm acquired a relatively small firm.

By singling out "special circumstances" in which market shares and the HHI are likely to underestimate the potential competition effects of the merger, it appears possible to better reflect "non-intervention thresholds" in past cases. It must be recognised that the "goodness of fit" in describing past practice is still not 100%, not even with the list of "special circumstances". Nonetheless, this approach, inspired by a similar approach in the Irish Merger Guidelines, allows the Commission to be as informative as possible in relation to the application of its merger control standard under "normal" circumstances. It is obvious that the HHI indicators ultimately chosen (in particular, the deltas) are higher than would have been possible if no list of special circumstances had been identified.[25]

As regards the interplay between the market share indicators and the HHI indicators, the following remarks can be made. From the outset, it is a good to realise that there is a difference in purpose for the two sets of indicators. The HHI indicators are meant to apply "across the board", covering all scenarios of possible competitive harm. By contrast, the market share indicator of 25% does not apply to situations of likely coordinated effects.

This leaves the competitive scenarios other than those involving coordinated effects, for which the question of interplay does arise. As is well known, it is not possible to match

[22] Art. 6(2) decisions. "Serious doubts" is the substantive standard for opening a Phase II investigation under the Merger Regulation.

[23] Art. 6(1)(b) decisions.

[24] 377 markets from 60 "dominance" cases; 273 remedies markets and 356 clearance markets from 75 Art. 6(2) cases; and 225 markets from 72 Art. 6(1)(b) cases from 2002.

[25] At the same time, the approach is by itself instructive to companies, as it highlights the cases where market shares and the HHI are particularly likely to "underestimate" the potential competition problems. This does, of course, not substitute for the full analysis in the later sections in the Guidelines. It is simply a "flag" to companies to tell them that if any of these factors are present, the thresholds are less useful as indicators.

a square with a circle. Or, in this context: market share indicators and HHI indicators cannot always give fully identical messages. However, it is possible to avoid contradiction. To this effect, the Commission made the choice to have the HHI indicators "point" in only one direction, to give the message a "soft safe harbour" meaning: below certain levels, the Commission is unlikely to identify competition concerns in a merger. The Guidelines do not say that above these levels, there are likely to be competition concerns (the HHI indicators take a neutral stance in this respect). In this way, the message of the HHI indicators is made consistent with the message of the 25% market share threshold. Depending on the level of market concentration and the market shares of the parties, either both indicators provide the same message ("unlikely to identify horizontal competition concerns"), one indicator gives this message and the other remains neutral, or both indicators remain neutral.

The 50% market share indicator relates to situations of single firm dominance. To ensure consistency, the list of special circumstances in which the HHI is given less weight contains a specific reference to one of the parties to the merger having a 50% market share pre-merger.