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**An Economic Perspective on the Jurisdictional  
Reform of the European Merger Control System**

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# **An Economic Perspective on the Jurisdictional Reform of the European Merger Control System**

*OLIVER BUDZINSKI*<sup>#</sup>

## **ABSTRACT**

The jurisdictional elements of the comprehensive 2004 reform of EU merger control are worth being analysed against the background of economic theory. Competence allocation and delimitation represent important factors for the workability of multilevel merger control regimes. The economics of federalism offer an analytical framework that can be adopted in a modified version in order to assess competence allocation regimes in competition policy. According to these theoretical insights, a given competence allocation and delimitation regime can be evaluated in regard to four criteria: internalisation of externalities, cost efficiency (the one-stop-shop principle), preference orientation, and adaptability.

The ‘old’ competence allocation and delimitation regime of EU merger control consisted of two elements: turnover thresholds and post-notification referrals. Analysis along the lines of the economics of federalism reveals considerable deficiencies of the ‘old’ regime. Thus, the results of the theoretical analysis are compatible to the dissatisfying empirical experience, which represented a major motivation for launching the reform process. However, the actual reform eventually left the turnover thresholds untouched. The main element of the jurisdictional reform was the introduction of pre-notification referrals and the addition of institutionalised network cooperation.

Against the background of the economics of federalism, one must conclude that the reform failed to significantly improve competence allocation in EU merger control. The internalisation of externalities, preference orientation, and adaptability have not been improved. Regarding the cost efficiency criterion, early, anecdotal and provisional empirical evidence hints towards minor improvements of the one-stop-shop principle, albeit merely in its centralising variant. This is contradicted by an increased opaqueness of the overall system due to the higher degree of complexity of the referral regime. The economic analysis in this article shows that the underlying problems of jurisdictional issues of the multilevel EU Merger Control System have yet to be sufficiently solved. Therefore, this article predicts that jurisdictional issues will remain on the reform agenda.

**Keywords:** competence allocation, economics of federalism, jurisdictional reform.

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## A. INTRODUCTION

With the enforcement of an all-new European Community Merger Regulation<sup>1</sup> as of May 1<sup>st</sup>, 2004, three areas of EU merger control policy were significantly reformed:

- the modification of the substantive standard for the prohibition of mergers ('significant impediment of effective competition' instead of 'creation or strengthening of a dominant market position')<sup>2</sup> plus the completion of Horizontal Merger Guidelines<sup>3</sup> (specifying an increased emphasis on modern industrial economics and quantitative methods<sup>4</sup> as well as introducing some sort of an efficiency defence<sup>5</sup>) [**substantive reform**],
- procedural changes (increased flexibility of timetables, increased investigation rights, etc.) [**procedural reform**], and
- a reform of the allocation of merger cases between the jurisdiction of the European Commission and community law and the jurisdiction of national competition authorities and laws of the Member States [**jurisdictional reform**].

All reform elements have been intensively and controversially discussed in the literature. However, and not surprising, the substantive changes have attracted more attention than the procedural and jurisdictional ones. This is particularly true regarding economic contributions.

However, the neglect of jurisdictional reform elements in the economic literature is not justified since these issues (i) considerably influence the overall performance of the European Merger Control System and, thus, impact merger activity as well as indirectly impact market structure evolution and (ii) represent the initial motivation of the reform process. While the substantive reform was added to the modernisation package comparably late (and in the light

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participants of the two conferences and for editorial assistance I thank Barbara Majireck. All remaining errors are mine.

<sup>1</sup> Council Regulation (EC) No 139/2004 of 20<sup>th</sup> January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), in: Official Journal L 24, 2004-01-29, pp. 1-22, replacing Council Regulation (EEC) No 4064/89 of 21<sup>st</sup> December 1989 on the control of concentrations between undertakings, in: Official Journal L 395, 1989-12-30, pp. 1-12.

<sup>2</sup> In particular, unilateral effects of mergers in heterogeneous oligopolies as well as enhanced and specified considerations of efficiency effects of mergers are introduced. See for analyses *Díaz* (2004), *Lyons* (2004), *Voigt/Schmidt* (2004a, 2005), *Zimmer* (2004), *Budzinski/Christiansen* (2005a), and *Levy* (2005). For theory-driven analyses of institutional change during the history of modern European competition policy see e.g. *Neugebauer* (2004, pp. 99-122) and *Budzinski/Christiansen* (2005b).

<sup>3</sup> Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings, in: Official Journal C31, 2004-02-05, pp. 5-18. See for analyses *Ridyard* (2004) and *Voigt/Schmidt* (2004b).

<sup>4</sup> This includes the appointment of a chief-economist (Lars-Hendrik Röller, Humboldt-University of Berlin).

<sup>5</sup> From an economic perspective, the effectiveness of the efficiency-related institutions remains doubtful. See *Schwalbe* (2005).

of the ECFI-judgements of 2001 as well as international criticism, for instance in the context of the eventually prohibited GE/Honeywell merger), the jurisdictional reform lied at the heart of the initial Green Paper<sup>6</sup>. In order to contribute to the tackling of the existing analytical gap, I provide an economic analysis of the 2004 reform of competence allocation and delimitation within the European Merger Control System. Before I describe and assess the ‘old’ (pre-reform) and the ‘new’ (post-reform) regime (sections C and D), I summarise existing theories of competence allocation in competition economics and derive a set of assessment criteria (section B).

## B. ECONOMIC THEORIES OF COMPETENCE ALLOCATION

The problem of the allocation and delimitation of competences in competition policy results from principally concurrent competences on cartels, mergers, and abusive strategies when they affect markets in different jurisdictions (irrespective of whether separated markets in different jurisdictions or integrated international/interjurisdictional markets are concerned). This well established and widely accepted principle is called the ‘effects doctrine’. The consequences of having multiple jurisdiction on competition cases (reviewed by multiple national competition authorities and subject to multiple national competition provisions) are analysed either with a focus on regional integration (such as the EU) or with a view to the benefits and limits of a global competition policy. In both issues, a need to coordinate the competent jurisdictions results, leading to the question of the design of the delimitation of competences and their allocation among the affected jurisdictions.

### 1. Existing Approaches: An Overview

*Barros and Cabral* (1994) as well as *Head and Ries* (1997) compare centralised decision making on international mergers by a single authority with decentralised (national) merger control in regard to welfare effects, in particular, the internalisation of external effects. They derive the general result that, under decentralised competition policy, inefficiencies arise whenever there is an asymmetric distribution of consumers and producers or company headquarters across the countries affected by a merger. In these (realistic) cases, national decisions makers, by adhering to the maximisation of national welfare - thus ignoring effects on foreign consumers and outbound competition - cause spill-overs and negative externalities on other jurisdictions. As a very generalised consequence of both models, in a world of imperfect extraterritorial antitrust enforcement and asymmetric countries, a world competition bureau represents the superior solution in order to internalise negative externalities resulting from national competition policies. Another treatment with compatible results is presented by *Tay and Willmann* (2005). In a two-country model with homogeneous products and where only profitable mergers are allowed, they analyse the effects of a merger on three participating

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<sup>6</sup> See *European Commission* (2001b).

groups: the merging enterprises (denoted ‘insiders’), other suppliers (‘outsiders’), and the buyers of the product. They present a comparative analysis of the aggregated welfare effects of three different competition policy regimes. According to their model, the ‘symmetric and non-cooperative territoriality regime’, i.e. a national competition authority has jurisdiction on mergers located within its territory and there is no coordination between the national authorities of the two countries, leads to an inefficient lax competition policy towards cross-border mergers. The second regime, the ‘non-cooperative extraterritorial enforcement regime’, i.e. both national authorities perfectly apply the effects doctrine without any coordination, generates a ‘global’ policy, which is inefficiently strict. In terms of welfare, both regimes are inferior compared to the ‘global authority regime’ because this third regime type perfectly internalises negative externalities.

However, this literature does not directly address competence allocation and in particular does not include questions of competence delimitation. More precisely, neither of them analyses or evaluates different rules for the allocation of competences beyond the simple ‘extreme’ solutions ‘single world authority’ versus ‘non-coordinated national authorities’. As *Neven and Röller* (2000, p. 849) emphasise, “it may be useful to consider more complex allocations of jurisdictions”, especially rules governing a coordinated simultaneous assertion of jurisdiction by horizontally- and/or vertically-interrelated competition authorities, and comparatively evaluate them in regard to their performance.<sup>7</sup> Moreover, the unsatisfactory results of the welfare-optimisation oriented literature can be read as a call for the importance of such an analysis. Although *Neven and Röller* (2000, 2003) enrich the discussion by taking effects-doctrine based simultaneous assertion of jurisdiction into account, their approach merely initiated an analysis along the outlined lines. Their two-country model with a homogeneous commodity does not depend on specific market structures or models of competition. In order to “investigate how different rules to allocate jurisdiction will affect the outcome”<sup>8</sup> in terms of welfare but also in terms of jurisdictional conflicts, they assume that mergers are prohibited if they exceed defined market shares. The two jurisdictions differ in regard to geographic market definition and it is sufficient if one jurisdiction bans the merger (perfect application of the effects doctrine). Although *Neven and Röller* (2000, p. 849) emphasise the importance of (more complex) rules for the allocation of jurisdiction, they effectively compare the simultaneous (uncoordinated) assertion of jurisdiction on the basis of the effects doctrine with the authority of a centralised world antitrust agency. Real-world competence allocation rules are generally much more complex.

A different branch of literature analyses the centralisation and decentralisation of competences against the background of insights from the economics of federalism, which have a long-standing tradition in analysing the benefits and limits of decentralising

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<sup>7</sup> A different question is whether there is a need for rules/institutions governing the allocation of competences or whether there can be a competitive solution instead (institutional or regulatory competition). However, *Kerber and Budzinski* (2004) have analysed this problem and derived only limited scope for competition elements in regard to competence allocation of competition laws.

<sup>8</sup> *Neven/Röller* (2000, p. 850).

(centralising) government competences (in particular public goods and taxes).<sup>9</sup> Additional to externalities, cost efficiencies, local preferences, the taming of Leviathan, and the idea of laboratory federalism are usually discussed.<sup>10</sup> The insights from the economics of federalism regarding the centralisation and decentralisation of competences are surprisingly infrequently applied to problems of multijurisdictional antitrust. However, two notable exceptions have to be remarked:

- The law-and-economics literature on American antitrust federalism analyses against a combined economic and legal background the interplay between antitrust competences of the US states and such of the federal government. In his landmark contribution, *Easterbrook* (1983) applies insights from the economics of federalism, deriving merits of decentralised antitrust competences, in particular favouring a competition among jurisdictions.<sup>11</sup> Similar to this article, he does address a specific competence allocation rule (the *commerce clause*). However, and quite typically for the American antitrust federalism literature in general, his analysis is focused on the specific environment and features of the US legal system.<sup>12</sup>
- *Van den Bergh* (1996), who seeks to specify the subsidiarity principle in regard to the allocation of competition policy competences between the European Commission and the Member States, and *Kerber* (2003) derive and apply economic criteria, which serve as a yardstick for the following normative problem: which tasks shall be allocated to the national authorities and which ones to the supranational one(s). However, possible rules to govern an allocation of competences along these lines are analysed only to a limited extent. Developing this approach, *Budzinski* (2005) explicitly includes competence allocation and delimitation rules in his analysis. He identifies nine stylised competence allocation rules<sup>13</sup>, which he comparatively analyses regarding their economic performances. However, the context of *Budzinski's* (2005) analysis is the design of a worldwide multilevel competition policy regime, while the focus of this article is on the most recent jurisdictional reform of the European merger control system.

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<sup>9</sup> See representatively *Salmon* (1987), *Breton* (1996), *Oates* (1999), and *Feld/Zimmermann/Döring* (2004).

<sup>10</sup> In order to save space for the actual analysis of competence allocation problems in the European Merger Control System, I abstain from reproducing the concrete derivation of these criteria, which are rather common in the economics of federalism literature. Instead, see among others the above cited references.

<sup>11</sup> The scope for a competition of competition laws is elaborately analysed from an economic perspective by *Kerber/Budzinski* (2004) with the result that its prospects do not significantly extend the general decentralisation advantages taken from the economics of federalism (namely the aspect of laboratory federalism).

<sup>12</sup> See exemplary for other law-and-economics based contributions *Fox* (2000), *First* (2001), *Guzman* (2001), *Hahn/Layne-Farrar* (2003), and *Posner* (2004).

<sup>13</sup> Effects doctrine, turnover thresholds, non-discrimination rule, best practice recommendations, location doctrine, relevant markets rule, X-plus rule, advanced comity principle, and mandatory lead jurisdiction model.

## 2. Economic Aspects of Competence Allocation and Delimitation in Merger Control

Combining the insights of the precedingly discussed theoretical approaches offers a set of economics-rooted criteria, which can serve for comparative assessments of competence allocation and delimitation regimes. In doing so, an economic evaluation and assessment of competence allocation/delimitation rules becomes possible. On the one hand, this represents an important input for the ongoing controversy regarding the ‘if’ and ‘how’ of a global competition policy regime.<sup>14</sup> Most of the papers cited above actually refer to the global antitrust debate. However, on the other hand, the same theoretical framework can be applied when analysing jurisdictional issues of the European Competition Policy System in which the European level and the national level (Member States) each carry out their distinctive competition policies. From an economic perspective, a sound competence allocation regime needs to accomplish the following criteria to the furthest possible extent:

- *Externalities and Spillovers*: this is emphasised by the overwhelming majority of the literature. Most generally, jurisdiction over an antitrust problem should be allocated to the jurisdictional level, which has the highest degree of congruency with the territorial or geographical scope of the problem. Otherwise, negative externalities provide incentives for the engagement in welfare-reducing strategies like selective (non-) enforcement of competition rules to discriminate against foreign producers or consumers (strategic competition policy). Positive externalities, on the other hand, result if competition authorities are expected to consider anticompetitive effects on the domestic market *and* on foreign jurisdictions’ markets. They obviously reduce the incentive to provide the related policies. Therefore, this points towards a centralisation of competences at the EU level if mergers affect markets that exceed the territory of at least one affected Member State. However, it also encompasses an argument for a decentralised allocation if only one national or sub-national (regional) market or separated markets in different Member States are affected.
- *Cost Efficiency*: whenever a merger affects markets in different jurisdictions (irrespective whether the markets are integrated or separated), concurrent competences can be constituted. Consequently, multiple reviews of one and the same merger case result, which cause both additional costs for enterprises (multiple filings, fees, translations, dealing with different legal regimes, increasing length of the overall procedure, danger of cumulating or contradictory obligations and decrees, increasing legal uncertainty, etc.) and additional costs for competition authorities (parallel review procedures of one and the same case). In economic terms, inefficient transaction costs arise whenever more than one jurisdiction is competent to review and judge a given merger. Cost efficiency is optimal if a merger is dealt with in a one-stop shop. This does not necessarily imply a centralisation of competences. Instead exclusive competences and a clearcut delimitation of

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<sup>14</sup> For a comprehensive analysis along the lines of this approach see *Budzinski (2005)*.



competences suffice, i.e. a given merger is reviewed either by the EU authority according to EU institutions or by a Member State authority according to its institutions. Generally speaking, transaction costs increase with the complexity and opaqueness ('fuzziness') of the competition regime.

- *Preference Orientation*: competition cultures as well as goals of competition policy differ among Member States.<sup>15</sup> This is rooted in different preferences of the citizens (the principal) about the (societal) role of market competition and, consequently, about the task of competition authorities and policies. This relates to questions like whether competition should be about efficiency only or should additionally (or alternatively) ensure economic freedom, balance regional economic performance, etc.<sup>16</sup> A striking example of such differences is the value judgement about the borderline between legitimate competitive behaviour and unfair competition: every society must define which types of business behaviour they are willing to accept as legitimate and which ones not. Another popular one relates to the extent to which industries like education or health services should be subject by market competition. Differing preferences across Member States demand a decentralisation of competences. Obviously, an uniform competition policy on the EU level cannot cope with differing (heterogeneous) preferences about e.g. acceptable supplier concentration or fairness standards of the Member States' citizens.
- *Adaptability*: competition policy regimes have to be flexible and capable of adapting to the evolution of their environments in order to cope with future challenges. Competition policy deals with creative enterprises, which innovate on anticompetitive arrangements and behaviours (evolutionary character of market competition). Furthermore, the scientific knowledge base of competition policy is subject to change. To begin with, different and competing theories and policy paradigms about (anti-) competitive effects of mergers exist.<sup>17</sup> Moreover, the scientific community innovates on competition theory (evolutionary character of the scientific competition of ideas). Decentralisation of competences enhances both the reaction flexibility (resonance ability) and the innovation permeability (openness to knowledge inflow) of the competition regime. The reason is not that each local agency and institution is inherently more adaptable. Instead, the decisive effect is that institutional and agential *diversity* (i) offers additional channels for the injection of new ideas and (ii) allows for mutual learning due to parallel experimentation with

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<sup>15</sup> See e.g. *Ullrich* (1998) and *Immenga* (2004).

<sup>16</sup> In democratic systems these decisions lie in the core of the self-definition of the society. It may decide to have economic efficiency as the only standard (which would be welcomed by a lot of economists) but it is – in a positive sense – absolutely legitimated to choose a different standard. In other words, a society may well be willing to pay an economic price in terms of efficiency losses in order to implement the (fairness) standards or pursue the goals they prefer. See in this regard also the landmark contribution by *Fox* (2003).

<sup>17</sup> See for empirical evidence *Aiginger/Mueller/Weiss* (1998) as well as *Aiginger et al.* (2001), and for theoretical reasoning *Budzinski* (2003).

different practices, concepts, ideas, institutional solutions, etc.<sup>18</sup> The existence and interaction of a horizontal (i.e. on the same jurisdictional level) and vertical (i.e. on upstream or downstream jurisdictional levels) variety and plurality represents an evolutionary value.

These four dimensions of economic criteria for competence allocation erect an analytical framework, which allows for an economic assessment of the jurisdictional elements of the 2004 reform of the European System of Merger Controls. However, they do not constitute a trivial optimisation task because any real-world regime will gradually match some of the criteria and, at the same time, violate others. Against the background that no ranking of these criteria can be derived from theory, one is limited to comparative assessments. Although no optimum is available, the conclusion that one given regime performs better than another given regime provides valuable insights regarding the design of competence allocation and competence delimitation rules.

## C. THE 'OLD' COMPETENCE ALLOCATION REGIME AND ITS DEFICITS

### 1. Features of the 'Old' Regime

The European Merger Regulation specifies the delimitation of competences in merger control. As a general rule, the Commission and the EU institutions are exclusively competent for each merger that has a *community dimension*. All other mergers within the EU fall under the competence of the Member States and their institutions and authorities. The concept of having a clearcut vertical allocation of competences with either the EU level or the Member States level being exclusively competent is called the *one-stop-shop principle*.<sup>19</sup> In order to operationalise the community dimension concept, the Merger Regulation contains quantitative thresholds that decide to which level a specific merger case is allocated. These thresholds apply to turnovers, following the intuition that the likeliness of a merger to have a community dimension increases with its size, which is approximately measurable by the turnovers of the participating enterprises. According to Art. 1 ECMR, a merger falls exclusively under the jurisdiction of the EU level if either (cumulating conditions each)

- the combined aggregate worldwide turnover of all the enterprises concerned exceeds 5000 million €
- the aggregate communitywide turnover of each of at least two of the enterprises concerned exceeds 250 million €

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<sup>18</sup> An uniform, centralised regime – on the opposite – can theoretically only test alternative practices sequentially. This slows down learning processes about best practices and benchmarks. Moreover, sclerotic institutions, refusing to deal with innovation, are more probable in centralised regimes.

<sup>19</sup> See e.g. *Brittan* (1990).

- unless each of the enterprises concerned achieves more than two-thirds of its aggregate communitywide turnover within one and the same Member State,

or

- the combined aggregate worldwide turnover of all the enterprises concerned exceeds 2500 million €
- in each of at least three Member States, the combined aggregate turnover of all the enterprises concerned exceeds 100 million €
- in each of at least three Member States, the aggregate turnover of each of at least two of the enterprises concerned exceeds 25 million €
- the aggregate communitywide turnover of each of at least two of the enterprises concerned exceeds 100 million €
- unless each of the enterprises concerned achieves more than two-thirds of its aggregate communitywide turnover within one and the same Member State.

All mergers, which do not meet these thresholds, are subject to the merger laws and authorities of the Member States according to their individual notification and review thresholds (which differ significantly between the Member States).<sup>20</sup>

The turnover thresholds determine the initial allocation of cases between the EU level and the Member State level. They are complemented by a referral regime.<sup>21</sup> The old Merger Regulation included provisions for post-notification referrals (Art. 9 and 22 ‘old’ EMCR), i.e. Member States could (i) reasonably request a downward referral of a merger notified to the Commission (only when competition on a distinct national market in that Member State is jeopardised) and (ii) conjointly refer a merger upwardly, which did not meet the thresholds but of which the NCAs collectively thought it should be a community case. Referrals in each direction remained within the discretion of the initially competent authority/ies.

## 2. An Economic Assessment of the ‘Old’ Regime

How is the ‘old’ regime consisting of turnover thresholds plus post-notification referrals to be assessed according to the economic criteria discussed in section B?

### *(a) Internalisation of Externalities*

A competence allocation based on turnover thresholds provides an imperfect internalisation of external effects. Regarding the vertical allocation of competences (among the EU- and the

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<sup>20</sup> See generally on jurisdiction in merger control within the EU *Burnley* (2002b), *Drauz* (2003), and *Budzinski/Christiansen* (2005b).

<sup>21</sup> See on the ‘old’ referral regime e.g. *Hirsbrunner* (1999), *Bright/Persson* (2003), and *Domínguez Pérez/Burnley* (2003).

Member State-level), the basic idea is that the larger a merger is in terms of the turnovers of the participating enterprises, the more likely are cross-border effects, wherefore mergers that meet or exceed a defined vertical threshold are exclusively allocated to the EU level. All other mergers are exclusively allocated to the Member State level. However, turnover thresholds represent a rather crude proxy for the geographic extent of the economic effects of a given merger.<sup>22</sup> The extent of the subsequent misallocation depends on the appropriateness of the actual threshold figures, i.e. whether they are too high or too low. However, due to the proxy character, a quantitative derivation of the appropriate threshold is impossible and any chosen figure more or less arbitrary.

Irrespective of the exact figures of the vertical turnover threshold, some cases are always misallocated. Some of the mergers between big companies that meet or exceed the threshold, nonetheless, exclusively affect markets within the Member States (i.e. have no original cross-border effects). Mergers in national utility markets (energy, water, etc.) used to represent typical examples (although at least the energy markets are currently in the process of becoming international markets). According to the turnover threshold-based competence allocation, they are allocated to the EU level although they would be appropriately treated on the Member State level. Thus, the European Commission is expected to provide positive externalities (antitrust policy on behalf of the Member States). Furthermore, there are cases where the threshold is not met but, nevertheless, cross-border effects result. This could be the case, for instance, in markets, which are generally characterised by small or medium-sized companies, but, nonetheless, have cross-border dimensions or are subject to integration/internationalisation processes. In such cases, scope for negative externalities arises since the case is reviewed by the affected Member States although the geographic scope of the case exceeds the one of each competent Member State.

Can the 'old' referral regime cure these internalisation problems? Indeed, there is microeconomic-theoretical potential for post-notification referrals to generate an externalities-reducing re-allocation of cases. However, a political-economic objection has to be raised. It crucially depends on the willingness of the initially competent authority (EU) or authorities (Member States) to hand the case over. The self-interest of the authorities (budget and importance maximisation; economics of bureaucracy) may represent a barrier against voluntary post-notification referrals. This is supported by the veto right of the Commission regarding downward referrals and by the requirement of joint referrals of all affected Member States in the case of upward referrals. Not surprisingly from an economic point of view, the voluntary post-notification referral regime was empirically assessed to be ineffective and deficient in curing the problems of the turnover threshold-based competence allocation. Multiple filings and reviews on the Member State level increased since the late 1990s<sup>23</sup> and

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<sup>22</sup> Theoretically, 'geographic relevant markets' would be the paragon. However, see below section 3.2.2.

<sup>23</sup> According to *Bright/Persson* (2003, p. 492), the ratio between multiple filings and EU notifications was 62 per cent in 2000, with a figure of 35 per cent in regard to multiple filings in three or more Member States. Total numbers of multiple filings reached almost 300 cases between 1992 and 2000.

more dynamics were to be expected in the face of the enlargement to 25 members. Moreover, both upward and downward referrals were rare as both the Commission and the NCAs were reluctant to engage in post-notification referrals.<sup>24</sup>

An additional theoretical problem of the turnover threshold-based competence allocation regime is often neglected. A provision regarding the horizontal allocation of competences on the Member State level is lacking. A horizontal threshold, demanding that a minimum affection of internal markets is required as a precondition for national jurisdiction over a specific merger<sup>25</sup>, would considerably reduce the scope for externalities because it reduces the number of competition policy regimes that are competent to deal with a below-the-vertical-threshold case. Such a provision would be adequately located at the EU level. The absence of a horizontal threshold, however, allows for more virtual market affections to generate jurisdiction, depending on the autonomously and non-coordinated shaped national provisions. As a matter of fact, the Member State provisions concerning the constitution of national jurisdiction over a merger differ significantly across the EU and at least some adhere to problematic standards.<sup>26</sup>

#### *(b) The One-Stop-Shop Principle*

Turnover thresholds possess a considerable advantage in terms of efficiency: turnovers of enterprises can be calculated and determined comparably easy and unambiguous. Thus, turnover thresholds serve as a cost-saving proxy for ‘geographic relevant markets’, which would be the theoretical paragon from an economic perspective. However, the delineation of relevant markets is a difficult, costly, and often controversial issue, which cannot sensibly be done before the competent jurisdiction(s) is (are) chosen and, thus, cannot serve as an instrument for competence allocation.<sup>27</sup>

A one-stop shop is always created by the EU turnover thresholds if a merger meets or exceeds the (vertical) threshold and, consequently, is exclusively allocated to the EU level. However, the one-stop-shop principle falls short if a specific merger does not meet the thresholds but, nevertheless, is forced to be notified (according to national law) to more than one Member State authority. In such cases, multiple parallel proceedings occur, causing an inefficient increase in transaction and administration costs. The extent of multiple reviews on the Member State level depends (i) on the figures of the vertical threshold and (ii) on the figures

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<sup>24</sup> See *European Commission* (2001), *Bright/Persson* (2003), and *Domínguez Pérez/Burnley* (2003).

<sup>25</sup> In doing so, Member State competition policy regimes, which do not experience a sufficient amount of domestic turnovers by the merging enterprises, are excluded from reviewing the arrangement.

<sup>26</sup> Among the Member States, notification rules for mergers differ significantly. Some Member States have turnover thresholds (with varying degrees of strictness), other market share thresholds (Greece, Spain, Portugal, Latvia, Poland, Slovak Republic, and Slovenia) or a ‘share of supply’ criterion (the UK), and sometimes a reference to a specific national jurisdictional nexus is completely lacking. See *Drauz* (2003, p. 20).

<sup>27</sup> See more elaborately *Budzinski* (2005, pp. 187-189, 218-221). See also *Werden/Froeb* (1993)

of the horizontal threshold. The first aspect highlights how much cases are allocated to the Member State level in general, whereas the second aspect contributes to determine how many Member States are competent for a given case. The vertical threshold in the EU Merger Control System, theoretically, is designed to support the one-stop shop. In particular, the two-thirds rule (assigning competence to the most impacted Member State) represents an element, which considers that the one-stop-shop principle does not necessarily imply centralisation but, instead, can include an important role for decentralised competences. However, without horizontal thresholds, the problem of multiple reviews is likely to be considerable, causing an inefficiently high burden on business and taxpayers, because it is not ensured that only a substantial impact on domestic markets constitutes jurisdiction over a specific Member State.<sup>28</sup> An ambitious and harmonised horizontal threshold would significantly reduce this problem, albeit not to zero.

The European Merger Control System implements another element in order to alleviate the deficiencies of turnover threshold-based competence allocation. The post-notification referral system re-allocates the competences to review and control a given merger. This could improve the one-stop-shop principle, in particular regarding joint upward referrals. However, the non-mandatory character of upward referrals, leaving them at the discretion of the NCAs, generates a conflict between the overall goal ‘better performance of one-stop shop’ and the NCAs individual goal ‘maintaining the importance of national agencies’ (with a view to maximisation of budget, staff, resources, political meaning, etc.).<sup>29</sup> As a consequence, it can be expected that voluntary upward referrals occur inefficiently rare in cases of multiple filings and (also) self-interested authorities. This theoretical derivation meets with the empirical evidence from the EU (see above section C.2.a). Moreover, a re-allocation through post-notification referrals leads to an increase in complexity that develops considerable negative impact in regard to procedural efficiency. Merging companies cannot be completely sure in advance, which authority according to what law (national/EU) will eventually review and control the merger.<sup>30</sup> Since notification and filing requirements along with time schedules differ between EU and Member States as well as across Member States, post-notification referrals cause additional costs due to re-filing.

### *(c) Preference Orientation*

To some extent, preference conformity may decrease in the course of time because of inherent centralisation tendencies of turnover threshold-based competence allocation. The (EU)

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<sup>28</sup> See the respective reference in section 3.2.1. The impact is even more severe regarding the violation of the one-stop-shop principle because multiple reviews can produce negative externalities but do not necessarily do so inevitably. Contrary, multiple reviews always generate cost inefficiencies (additional transaction costs).

<sup>29</sup> The politico-economic aspects of the modernisation of the European System of Competition Policies are elaborately discussed by *Budzinski/Christiansen* (2005b).

<sup>30</sup> Insecurity is increased by two features of the ‘old’ referral regime: lacking of clearcut criteria for referrals (which cases are subject to post-notification referrals?) and voluntary character of the referrals (will the initially competent authorities refer or not?).

turnover thresholds are codified in nominal quantities and remain static. However, two driving-forces promote centralisation, i.e., in the course of time, an increasing number of mergers meet or exceed the threshold. Firstly, inflation tends to increase the nominal turnovers of merging companies without increasing their real impact. Secondly, the process of European integration and the more general tendency towards the internationalisation of business activities (including trade liberalisation) enlarges markets. Increasing market sizes may require larger company sizes in order to do business in an efficient way. Accordingly, within the European Merger Control System, the share of mergers allocated to the EU level has considerably increased at the expense of mergers that fall under the jurisdiction of Member States. Thus, a turnover threshold-based competence allocation tends to marginalize decentralised competences in the course of time: in tendency, the national competition rules and agencies become omitted.

The process of creeping centralisation of competences tends to reduce preference conformity because national differences in preferences about competition policy cannot be adequately reflected in those cases that are allocated to the EU level. This effect may be aggravated by the enlargement of the EU, in particular, since the majority of new EU members have a completely different tradition of antitrust and the ongoing transition process may demand a different antitrust policy. Additionally, centralising forces favour an international (EU) bureaucracy, which is further from the citizens and, therefore, agency problems may increase. The negative effect is particularly severe in cases where predominantly national cases exceed the turnover thresholds and, consequently, the European Commission becomes exclusively competent.<sup>31</sup> This could be cured by post-notification downward referrals by the Commission. However, the Commission is not obliged to refer such a case to the predominantly impacted Member State; it disposes over discretionary power to do so or to refuse. It can serve the self-interest of the Commission to enlarge its competences and the frequent complaints of NCAs about unavailing referral requests as well as the small numbers of downward referrals support these concerns.<sup>32</sup>

#### *(d) Adaptability*

Competence allocation according to turnover thresholds can provide a considerable variety of merger control institutions and practices. Both the EU and all the Member States are entitled to produce their own competition rules and policies. Principally, they are autonomously competent in shaping and developing their institutions and practices. Moreover, the interaction of the different merger control regimes becomes intensified, systemised, and more explicit, so that incentives for mutual learning are improved. Altogether, significant scope for parallel experimentation and a variety of channels for the injection of innovation can be expected, leading to a principally high adaptability of the European Merger Control System.

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<sup>31</sup> The two-thirds rule effectively reduces the frequency of such cases. Nevertheless, they can and do occur.

<sup>32</sup> See more elaborately on this aspect *Budzinski/Christiansen* (2005b, pp. 315, 320-322, 329-331).

However, this generally positive assessment must be qualified if centralising forces dominate the system's evolution. If the competences of the Member States are marginalized and omitted because an ever-increasing number of cases is allocated upwards due to ongoing integration and a creeping extension of the EU's competences, then incentives for an ostensibly 'spontaneous harmonisation' of the Member State institutions and agencies are generated. If there is no considerable scope for distinct national competition policies (due to a lack of practical meaning, not theoretical competence), why not simply copy the supranational provisions or give up national efforts altogether? At least, this saves administrative costs. However, antitrust diversity is effectively eroded. Regarding the merger control within the European Union, such a 'voluntary' adaptation of EU-styled competition rules by the (old and new) EU Member States is documented.<sup>33</sup> This particularly concerns the smaller Member States and the new Member States. By contrast, some of the old and bigger Member States possess a powerful tradition in merger control and have always powerfully withstood competence centralisation.<sup>34</sup>

### 3. Conclusion

In summary, the 'old' regime must be assessed to be problematic from an economic perspective. Turnover thresholds as the major competence allocation instrument represent a comparably simple and unambiguous technique, possessing a high practicability. They provide a considerable amount of internalisation. Problems of the European Merger Control System are identified particularly regarding two aspects: (i) multiple proceedings accumulate in below-threshold cases and, at the same time, (ii) centralising dynamics lead to a creeping marginalisation of national regimes. The economic analysis in this section implies that these problems do not predominantly stem from defective quantities of the thresholds. Instead, two deficient elements of the 'old' regime mainly produce the negative effects:

- The post-notification referral regime is largely ineffective due to its voluntary and non-binding character. However, an effective re-allocation regime would be beneficial because turnover thresholds merely represent a more or less crude proxy for geographic relevant markets. This creates scope for an anticipatable, rule-based, and mandatory beneficial re-allocation of competences.
- The missing horizontal threshold allows for interest-driven claims of jurisdiction by Member States, even though they sometimes merely experience a 'virtual' nexus to the reviewed merger case. Allocating competences towards the decentralised jurisdiction, which experiences the most serious impact of a given merger, would represent an improvement, since the one-stop-shop principle could be better fulfilled without reinforcing centralising dynamics.

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<sup>33</sup> See *Vedder* (2004).

<sup>34</sup> See *Budzinski/Christiansen* (2005b).



## D. THE REFORM: ALLEVIATING THE DEFICIENCIES?

### 1. Features of the 'New' Regime

During the reform process, a number of interesting and innovative ideas on how to design competence allocation and delimitation were discussed.<sup>35</sup> However, in the end, the turnover thresholds were left untouched and the referral regime was reformed instead.<sup>36</sup> In order to become more 'streamlined', post-notification referrals are modestly enhanced and pre-notification referrals are introduced. However, no mandatory referrals were agreed upon. Regarding post-notification referrals<sup>37</sup>, a right of initiative for the Commission to invite a Member State request for downward referral complements the existing rules. Additionally, the formal requirements are alleviated (for example, shortened deadlines, simplified formal criteria, less administrative efforts, etc.).<sup>38</sup> However, the Member State is not obliged to request (following a respective invitation by the Commission) and, as it was before, the Commission may veto downward referrals at its discretion (at least, if it had not invited a request).

The major innovation is the introduction of pre-notifications referrals (Art. 4 (4-5) ECMR). The merging enterprises are entitled to request pre-notification referrals, i.e. in cases where the thresholds are met, enterprises may vote for Member State competence and vice versa. Only requests according to the following reasons are allowed:

- in case of pre-notification downward referrals, the merger must raise concerns that it significantly affects competition in a market within a Member State, which presents all the characteristics of a distinct market, and
- in case of pre-notification upward referrals, the merger must be subject to review in at least three Member States.

Three veto rights are implemented:

- in case of pre-notification downward referrals, the Commission can veto (without being obliged to give reasons),

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<sup>35</sup> In particular, the introduction of a '3plus rule' as an alternative proxy for relevant markets, replacing the turnover thresholds, was discussed. According to a 3plus rule-based competence allocation, any merger, which must be notified in three or more Member States, automatically becomes an European case, whereas all other mergers remain subject to national jurisdiction. An economic analysis of this type of competence allocation rule is provided by *Budzinski* (2005, pp. 189-190, 221-225). For an overview of the controversy accompanying the reform debate see *Drauz* (2003).

<sup>36</sup> See on the reform aspects concerning competence allocation *Domínguez Pérez/Burnley* (2003), *Drauz* (2003), *Díaz* (2004, pp. 179-184), *Budzinski/Christiansen* (2005a, 2005b), *Levy* (2005, pp. 111-112), and *Soames/Maudhuit* (2005, pp. 58-64).

<sup>37</sup> Art. 9 ECMR addresses post-notification downward referrals, whereas Art. 22 ECMR addresses post-notification upward referrals.

- in case of pre-notification downward referrals, the Member State concerned can veto, and
- in case of pre-notification upward referrals, each Member State concerned can veto.<sup>39</sup>

## 2. An Economic Assessment of the Reformed Regime

In regard to the internalisation of externalities the principal benefits and deficits of turnover threshold-based competence allocation have not (been) changed (see section C.2.a). The same is true for the post-notification referral regime. The additional introduction of pre-notification referrals is the major new element concerning the jurisdictional reform. However, it remains unclear why merging companies should be entitled to select the level of jurisdiction by which they want to be reviewed and controlled. An obvious danger of such regulations is forum shopping, i.e. the merging parties choose the jurisdiction expected to be the most permissive or the least hostile one. Considerable scope for forum shopping would create additional externalities and deteriorate competence allocation. However, due to the extensive veto rights by the involved competition authorities, it seems unlikely that forum shopping will become a considerable problem. Altogether, the internalisation capability of the European Merger Control System has been neither improved nor deteriorated through the jurisdictional reform. Apart from this assessment, it is not convincing why merging enterprises should decide about regulatory competence allocation.

Concerning the one-stop-shop principle, the smoothening and simplification of post-notification referrals must be noticed as an advantage. Pre-notification referrals may further accelerate the re-allocation procedure and improve the anticipation of its results by the (requesting) merging companies. If it had worked perfectly, multiple reviews would have been effectively limited to double reviews because each merger, which had to be notified in three or more Member States, could have requested pre-notification upward referral. However, the extensive veto rights of the involved authorities actually imply discretionary power of the antitrust agencies over pre-notification referrals. Since their incentives (self-interest) naturally have not changed in the course of the reform, a considerable increase of upward allocation of multiple filing cases seems doubtful. Moreover, no horizontal threshold was introduced so that the claim of national jurisdiction over a merger remains in the autonomy of the Member States (no *ex ante* reduction of potentially ‘competent’ jurisdictions). Similarly, downward referrals from the Commission to predominantly impacted Member States remain subject to discretion. Given the self-interest of the authorities and the

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<sup>38</sup> See Commission Notice on Case Referral in Respect of Concentrations, available at [http://europa.eu.int/comm/competition/mergers/legislation/consultation/case\\_allocation\\_tru.pdf](http://europa.eu.int/comm/competition/mergers/legislation/consultation/case_allocation_tru.pdf), to be published in the Official Journal.

<sup>39</sup> That means, for instance, that if a merger does not meet the thresholds but is subject to reviews in e.g. 11 Member States, the veto of one of those Member States (even if all the others want to refer) suffices to suspend the one-stop-shop principle. More probable than not, such cases will happen in the EU-25.

maintained voluntary character of the referral regime, one must be sceptical whether the increasing likelihood of multiple reviews in an EU25 can be compensated by the jurisdictional reform elements. Nevertheless, according to the Commission, 35 out of 39 pre-notification referrals have been exercised successfully between May 2004 and September 2005. Commissioner Kroes claims that, consequently, 239 separate national reviews have been avoided as a result of the new referral arrangements.<sup>40</sup> This can be assessed as an improvement, even though the cited communication from the Commission hints to the existence of cases where enterprises refrained from requesting pre-notification referrals following informal communication with the Commission or NCAs about the propensity of approval. In summary, from a theoretical perspective it has to be emphasised that the streamlining of the referral regime still depends on the goodwill of the Commission and the NCAs (continuing lacking of mandatory referral provisions). The decisive question is whether an increased willingness of the competition authorities to refer cases is related to the reform or rooted in different (sustainable?) reasons. Additionally, regarding the criterion of cost efficiency, an aggravation must be expected due to the increased overall complexity of the competence allocation regime in the European Merger Control System (additional introduction of pre-notification referral rules).

Regarding preference orientation, the modified referral regime seems to promote the centralising tendencies. Successful pre-notification referrals are dominated by requests for upward referrals (approx. 87%), more precisely, 34 out of 39 requested (30 out of 35 approved) pre-notification referrals possessed an upward direction.<sup>41</sup> A strengthening of the role of national merger control regimes in cases of predominantly national relevance cannot be found. However, the Commission started to push for more centralisation in late 2005 when it called for a revision of the two-thirds provisions in the turnover thresholds.<sup>42</sup> This aims at mergers in national industries, in particular net industries (like energy, utilities, and infrastructure), over which the Commission desires competence. This indicates that an expansion of one-stop shops on the Member State level (following some most-impacted clause in analogy to the two-thirds provision) through the referral regime cannot be expected since its voluntary character and the extensive veto rights enable the Commission to effectively block such a development. It seems doubtful that this matches the preferences of the respective citizens.

Concerning the adaptability criterion, the reformed referral regime can be expected to lack considerable impact. Despite pre-notification referral requests tending towards centralisation (because merging enterprises obviously prefer the Commission and EU law; see preceding paragraph), the extensive veto rights together with the two-thirds provision of the turnover thresholds allow the NCAs to secure their importance if they wish to. However, the jurisdictional reform yielded no improvement in terms of sustainably institutionalising merger

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<sup>40</sup> See for the data *Ryan* (2005, pp. 38-41) and for the Commission's assessment *Kroes* (2005, pp. 3-4).

<sup>41</sup> See *Ryan* (2005, pp. 38-41).

<sup>42</sup> See *European Commission* (2005).

control diversity within the EU. Furthermore, the most recent activities of the Commission to erode the two-thirds rule<sup>43</sup> point towards ongoing centralisation tendencies.

Altogether, the two main deficits of the ‘old’ regime – voluntary character of the referral regime and missing horizontal threshold (see section C.3.) – have not been cured through the reform. Instead, referral rules have become even more complex, increasing the opaqueness of the overall European Merger Control System.

### 3. The Additional Introduction of Network Governance and its Implications

To some extent, the Commission and the Member States seem to acknowledge the deficiencies of the reform. At least they find it necessary to introduce a network between the competition agencies within the EU<sup>44</sup> in order to create what can be called a *soft guide towards more efficient competence allocation*<sup>45</sup>. As an overall principle for soft allocation, the *centre of gravity principle* is introduced. However, its content remains rather vague by simply stating that any anticompetitive arrangement or practice should be located – without mandatory character – “where the main effects will be felt”.<sup>46</sup>

Concerning merger policy, the respective network shall enhance efficiency and effectiveness of the referral process in order to achieve a “more streamlined system of referrals” (Drauz 2003, p. 22). However, this does not give the impression of a sound post-reform competence allocation regime. The network shall improve the referral regime by facilitating both upward and downward referrals due to the enhanced and deepened cooperation. Consensual arrangements shall secure that “a case is dealt with by the most appropriate authority, (...) with a view to ensuring that multiple notifications of a given concentration are avoided to the greatest extent possible (...)” (Recital 14 ECMR).

While the ‘centre of gravity principle’ points towards a non-centralising improvement of the one-stop-shop principle, i.e. assigning exclusive competences not only to the Commission but also to one specific Member State, if it experiences the most serious impact, the decisive question is whether voluntary network cooperation can heal the deficits of lacking mandatory referral rules and lacking horizontal thresholds. With respect to the comparable approach of the International Competition Network, Budzinski (2004) argues that there are theoretical benefits of network cooperation in this regard, however, they are unlikely to be realised comprehensively.<sup>47</sup> Thus, the network represents a non-negligible improvement but one, which merely becomes necessary because of the shortcomings of the jurisdictional reform.

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<sup>43</sup> See *European Commission* (2005).

<sup>44</sup> Recital 14 of the new ECMR explicitly calls for the formation of a ‘network’ consisting of the Commission and the NCAs acting ‘in close cooperation’.

<sup>45</sup> See *Budzinski/Christiansen* (2005b).

<sup>46</sup> *Monti* (2004, p. 496). See on the networks of European competition authorities *Budzinski/Christiansen* (2005b), *Smits* (2005), and *Wilks* (2005).

<sup>47</sup> An abstract economic analysis with compatible results is provided by *Budzinski* (2005, pp. 184-186, 207-213).

Considering the voluntary character of network cooperation, this might not be significant enough to prevent jurisdictional issues from re-entering the reform agenda in the near future.

## E. CONCLUSION: THE REFORM FAILED TO IMPROVE COMPETENCE ALLOCATION

The jurisdictional elements of the comprehensive 2004 reform of EU merger control are worth being analysed against the background of economic theory. Competence allocation and delimitation represent important factors for the workability of multilevel merger control regimes. The economics of federalism offer an analytical framework that can be adopted in a modified version in order to assess competence allocation regimes in competition policy. According to these theoretical insights, a given competence allocation and delimitation regime can be evaluated in regard to four criteria: internalisation of externalities, cost efficiency (the one-stop-shop principle), preference orientation, and adaptability.

The 'old' competence allocation and delimitation regime of EU merger control consisted of two elements: turnover thresholds and post-notification referrals. The analysis along the lines of the economics of federalism reveals considerable deficiencies of the 'old' regime. Thus, the theoretical analysis yields results that are compatible to the empirical experience. Dissatisfying experiences with the 'old' regime represented a major motivation for kicking off the reform process. However, after a controversial debate, the actual reform left the turnover thresholds untouched. The main element of the jurisdictional reform was the introduction of pre-notification referrals and the addition of institutionalised network cooperation.

Against the background of the economics of federalism, one must conclude that the reform failed to significantly improve competence allocation in EU merger control. The internalisation of externalities, preference orientation, and adaptability have not been improved. Regarding the cost efficiency criterion, early, anecdotal and provisional empirical evidence hints towards minor improvements of the one-stop-shop principle, albeit merely in its centralising variant. This is contradicted by an increased opaqueness of the overall system due to the higher degree of complexity of the referral regime. The economic analysis shows that the underlying problems of jurisdictional issues of the multilevel EU Merger Control System have yet to be sufficiently solved. Therefore, it can be predicted that jurisdictional issues will remain on the reform agenda – and the latest developments regarding the two-thirds rule of the turnover thresholds support this assessment.

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