

The Logic of Delegation: Explaining the Evolution of EU Merger Control

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Abstract

Council Regulation 4064/89, otherwise known as the Merger Regulation, affected a significant transfer of authority from domestic competition authorities to the European Commission. Most analyses exploring the origins of this legislation focus on the negotiating dynamics among member governments in the Council of Ministers. This paper argues that, alone, such explanations are inadequate. They too often they view legislative outcomes as an event, rather than an endpoint of a process. Instead, an adequate understanding of the Regulation must focus on the broad history of merger control and, in particular, the role played by the Commission. Specific attention is paid to the impact of the Commission's dual-track effort to give merger control a Community dimension. The final section of the paper examines the administrative framework embedded within the Regulation. The paper argues that the relationship between member governments and the Commission can be usefully analyzed employing concepts and analytics borrowed from principal-agent theories.

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I. INTRODUCTION

Council Regulation 4064/89 on the Control of Concentrations between Undertakings, more commonly referred to simply as the Merger Regulation, entered the European Union's legal lexicon on 30 December 1989.¹ What is striking about the Merger Regulation is not that it set forth the legal and administrative framework for a Community-based system of merger control—for the internal logic of integration suggests that merger control should sooner or later attain a Community dimension—but that the system was crafted such that the European Commission exercises near monopoly administrative and executive power. Pursuant to the provisions embedded within the Merger Regulation, any corporate merger or acquisition meeting certain minimum threshold criteria is subject to evaluation and approval by Commission competition authorities. The decisions rendered by the Commission, moreover, are final. Neither firms nor governments have the authority to alter or overrule them. Firms that fail to conform to Commission decisions are subject to sizable fines.

That the Merger Regulation has become a part of Community law raises two interesting and related questions. The first is, quite simply, “Why?” Why did member governments, through their representation in the Council of Ministers, cast a unanimous vote in favor of a regulation addressing the control of mergers? While the Framers elected to include a body of competition rules relating to the control the anti-competitive cartels (Article 85) and the abuse of dominant position (Article 86), the Treaty of Rome made no mention, implicit or explicit, of the need to control mergers. If the Treaty of Rome can be said to reflect the general will among the member governments in 1957—to wit, that merger control was not a central concern of member states—why then did these countries come to agree that such regulatory legislation was needed in 1989? How can we account for this change?

The second question concerns the nature of the administrative apparatus built into the Merger Regulation: Why did governments delegate merger control authority to the Commission? As I argue in a companion paper, member states originally delegated to the Commission a relatively limited grant of authority to administer and enforce the competition provisions contained in the Treaty of Rome (Doleys 1999b). Yet, in the Merger Regulation, we find a far more extensive grant of authority. The provisions contained therein do not simply affirm or enhance competencies already granted under the Rome Treaty. Rather, the legislation carves out for the Commission an altogether new competence. It confers *exclusive* control over the vetting of corporate mergers to the European Commission. Again, we can ask, why the change? Why did member states voluntarily abrogate their authority in this area of economic regulation? Why didn't governments instead create an alternate mechanism that gave member state competition authorities, either individually or collectively, the authority to oversee and control Community merger activity? Or, more straightforwardly, why didn't member governments simply harmonize domestic competition rules and eschew a Community identity for merger control altogether?

¹ OJ L 395, 30 December 1989.

To date, there have been few scholarly examinations of the development of merger control. Perhaps the most theoretically sophisticated effort to date is the recent article by Simon Bulmer (1994).² Bulmer depicts the evolution of merger control as a stepwise progression of “policy regimes”. Defined as a “set of rules and/or norms setting out the principles of policy,” he identifies four discreet regimes: the Treaty of Paris, Article 85 (Treaty of Rome), Article 86 (Treaty of Rome), and the 1989 Merger Regulation. Informed by an institutionalist perspective, Bulmer places explanatory emphasis on the interaction among various EC institutions. He focuses, in particular, on the European Court of Justice (ECJ) and the Council of Ministers. He credits the ECJ with promulgating decisions that fundamentally altered the prevailing understanding of Treaty competition rules. In so doing, the Court effectively prompted member governments into action. He reserves special emphasis, however, for the role played by the member governments themselves. He credits them with negotiating and eventually passing the Merger Regulation.

Bulmer’s analysis is a major contribution to our understanding of Community merger control. However, it fails to provide a complete picture of the complex story behind the Merger Regulation itself. The principle shortcoming of the paper, as I see it, is the lack of a clear link among the policy regimes. There is nothing to provide a sense of continuity and connectedness. The very way Bulmer defines “regimes” suggests that they are somehow separate aspects of the analytical terrain, rather than constituent elements of a broader geography. Without an analytical thread linking the regimes, it is difficult to discern a single history of merger control.

In this paper, I seek, in a sense, to augment the analysis offered by Bulmer. With regard to the question “Why a Merger Regulation?”, I concur with Bulmer that we must look at Community merger control efforts with a long view. With an eye toward the past, we see that the Merger Regulation is not simply the product of a single decision in the Council of Ministers, but rather, it is the culmination of a lengthy policy evolution. However, I go beyond Bulmer’s representation of separate policy regimes by suggesting that they are linked. The common thread running through the history of merger control is the Commission.

In taking the position that the Commission is the central institutional actor in the merger control story, I do not wish to give the impression that either the Court or Council is unimportant. Quite the contrary. It is beyond dispute that the ECJ played an important role in structuring the political environment through the reasoning in its decisions. Also, there is no denying that member governments determined the fate of successive merger control proposals through votes cast in the Council. Rather, the principal purpose of this paper is argue that any complete picture of Community merger control must focus on the critical, if not central, role of the Commission.

² Other useful studies that trace the origins and evolution of the Merger Regulation include, Allen (1977, 1983, 1996) and Hoelzler (1990). There are also a number of excellent analysis conducted by legal scholars. Two that I found particularly informative and insightful are Goyder (1993: Ch. 20) and Schwartz (1993).

I build this argument around what I see as a sustained two-track effort on the part of the Commission to forward the cause of merger control. The first track involves efforts to introduce merger control via legal and procedural maneuvering. Beginning with a 1966 policy memorandum, the Commission made clear that its intention to use its authority to interpret existing competition rules aggressively as they applied to the anticompetitive effects of mergers. In addition to these efforts to expand its *de facto* voice in merger control using its existing authority, the Commission also pursued a strategy aimed at extending its *de jure* power. The Commission used its privileged position in the legislative milieu to offer successive proposals aimed at giving merger control an explicit Community identity.

The plan of the paper is as follows. In the first section, I provide a brief review of the authority delegated to the Commission under the Treaty of Rome. The aim is to place merger control within the broader framework of competition policy. In the second section, I chronicle the evolution of merger control, giving particular attention to the two-track effort by the Commission to carve out for itself an enhanced role in Community mergers policy. In the final section of the paper, I examine the administrative framework built into the Merger Regulation. I employ the heuristics of principal-agent theory to explore why the details of the Regulation took the form they did and, in so doing, highlight the tension between delegation and control that is at the heart of member state-Commission relations.

II. THE EVOLUTION OF MERGER CONTROL

A. The Treaty of Rome and Merger Control

Effective merger *control* is predicated on the ability of authorities to *prevent* anticompetitive concentrations of market power. Understood as such, it is clear that the Treaty of Rome contains no provisions designed to function as the statutory basis for the ex ante appraisal of mergers and acquisitions. Indeed, the Treaty makes no mention at all, implicit or explicit, of the need to address the potential anticompetitive effects of this type of firm activity. The Treaty includes only two articles that address directly the impact of firm behaviors on Community markets. They are narrowly focused on two specific types of behavior: collusion (Article 85) and market dominance (Article 86). Neither the letter nor the spirit of these articles speaks per se to merger control.

Article 85, for its part, holds that that concerted firm practices that distort competition in Community markets, such as supply or distribution cartels, are to be prohibited (see Appendix). There is no indication or suggestion in the provisions of the article that these prohibitions should apply to merger activity, even where a prospective merger may create restrictive supply conditions. A reading of the article strongly suggests that the narrow object of Article 85 is to address *agreements among firms*, and not the *creation of a firm*.

Similarly, Article 86 offers no indication that it is designed to apply to merger activity

(see Appendix). Article 86 holds that firm(s) possessing a dominant position in Community markets are prohibited from *abusing* this market power. While the article perhaps speaks more directly to the concerns at the heart of merger control than Article 85, there is again no indication, explicit or implicit, that the Framers of the Treaty intended that it should be used as a basis to prohibit mergers. In fact, the language of Article 86 suggests that prohibitions are to be addressed narrowly to the current actions of firms, not to potential or even likely effects of some future behavior. Support for this reading is found in the fact that the article provides no “approval” process. Instead, dominant firms, whatever the origins of their market power—whether via internal growth or external acquisition—fall within the jurisdiction of Community competition law only *after* abuses of market position are manifest.

It is not difficult to explain why the Treaty of Rome lacks a formal mechanism for merger control. Two plausible explanations can account for this fact. First, at the time the Treaty was being negotiated, most member states themselves lacked domestic merger control legislation. In the late 1950s, only Germany among the original EC(6) had anything approaching a coherent framework of national competition laws.³ In point of fact, during this era there was a tendency among national governments to *promote* rather than control mergers.⁴ Far from seeking to limit concentrations, the national laws of most member states implicitly or explicitly encouraged the oligopolization of strategic industries. Increased concentration was viewed as a means for national industry to recover regional and global competitiveness. The French system of “indicative planning,” for instance, sought explicitly to cultivate national champions through a combination of subsidies, sectoral coordination and selective trade protection. The Italian government similarly encouraged concentration through targeted incentives and extensive state ownership.⁵

The second reason the Treaty lacked a formal mechanism of merger control has to do with the intent underlying the document. The Treaty of Rome is a *traite-cadre*. A *traite-cadre* is an agreement that sets out general aims and goals, but requires parties to the agreement enact a great deal of secondary legislation (Bulmer 1994:427). Because the competition provisions in the Treaty are intended to apply to a wide range of economic sectors, the Framers were unable to negotiate a fully articulated agreement that would apply evenly across all policy domains.⁶ Instead, they produced a compromise

³ The Dutch had laws that required firms to notify authorities of pending mergers, but the legal restrictions against concentrations were few (and exemptions to these restrictions were granted liberally). The other founding member states—France, Italy, Luxembourg and Belgium—had no legal restrictions to speak of.

⁴ It was not that the Framers did not consider the value of the Commission involvement. In point of fact, member states had delegated considerable authority to the High Authority under the Treaty of Paris to regulate mergers in the coal and steel sectors (Article 65 and 66). Rather, negotiators believed that merger control was either unnecessary or should remain the domain of national authorities.

⁵ For informative overviews of the relationship between government, firms and industrial development in the major European countries during the early post-war period, see Shonfield (1965), Vernon (1974), Boltho (1982), and Graham and Seldon (1990).

⁶ For an extended effort to explain the nature and content of the competition provisions contained in the Treaty of Rome, see Doleys (1999b).

document, an agreement whose specifics would have to be hammered-out over time.⁷

B. The Community's First Decade

i. *Council Regulation 17*

The wellspring from which the Commission would draw the authority to begin its push to give merger control a Community dimension was provided in Council Regulation 17. Under Article 87 of the Treaty of Rome, member states were called upon to settle jurisdictional questions left unresolved during the negotiation of the Treaty (see Appendix). Articles 85 and 86 provide substantive provisions relating to the rules that would govern Community competition, but neither provided for the creation of an administrative apparatus capable of enforcing those rules. Jurisdictional responsibilities, particularly the relationship between national authorities and Community institutions, remained unclear. Therefore, to fulfill its charge under Article 87, the Council considered legislation outlining the responsibilities of various Community institutions. After much debate, Council Regulation 17 was adopted in 1962.⁸

Regulation 17 was a landmark piece of Community legislation. It represented a marked departure from the institutional status quo ante as it affected a major transfer of authority from national competition authorities to the Commission. It centralized the enforcement of competition rules in order to ensure their uniform interpretation and application. While Regulation 17 did not create a set of rules that would apply in all cases, it did detail the rights and powers granted to those involved in the policy process. Notably, the administrative centerpiece of the Community competition regime would be the Commission.

Regulation 17 provided Commission a degree of enforcement authority they did not enjoy hitherto.⁹ Member governments delegated to Commission officials the authority to initiate proceedings against firms whose behavior raised questions under Treaty competition rules. They were given substantial and invasive investigative powers. Commission authorities may not only request information from firms suspected of violating competition rules, but they also have the power to enter any premises, when necessary, in order to examine the books or business records (Article 14). Regulation 17 also conferred upon Commission officials the legal authority to compel offending firms

⁷ The Treaty of Paris, by contrast, is a *traite-loi*. The Treaty set forth a body of well codified laws that specified ex ante the rules and procedures in the policy domains covered by the agreement—coal and steel. The Treaty of Paris even included explicit merger control provisions (Bulmer 1994).

⁸ For an informed overview of the debates from one of the participants, see von der Groeben (1985:108-111).

⁹ During negotiations, France had sought to require that DG IV obtain the approval of a majority on the Council of Ministers before taking a decision. However, other member states rejected the French position on the grounds that Community functionaries should be insulated from national political influence. In the end, the French position was defeated. Although Article 20(2) establishes an “advisory committee” of Council representatives with whom DG IV officials are required to consult, they were not obliged to act of the committee’s position. The advisory committee’s report was just that, advisory. It carried no binding force.

to terminate infringements. To this end, the Regulation gave the Commission the ability to levy fines of up to UA 1 million¹⁰ or ten percent of annual turnover (Article 15)..

ii. *1966 Commission Memorandum*

It was clear from the earliest years of the Community that the Commission regarded the absence of merger control as a serious omission from the Community's regulatory arsenal (Allen 1996:170). Authority delegated under Regulation 17 notwithstanding, merger control still remained formally outside the Community framework and thus beyond the Commission's jurisdictional purview. Dissatisfied with the state of affairs, the Commission published a lengthy policy paper on the relationship between competition and merger activity. In this document entitled, *The Problem of Industrial Concentration in the Common Market*, the Commission made clear its belief that merger activity, under certain circumstances, could, and should, be subject to Community oversight.

The primary focus of the memo was the tension between the value of "European" scale firms and the contribution of small and medium-sized enterprises. At issue was the degree to which excessive concentrations of market power threatened the continued viability of smaller, but no less vital, firms and thereby the dynamism inherent in a competitive market economy. The Commission argued that it intended to use the authority granted under Regulation 17 to ensure that competitive market structures would be preserved. The Europeanization of firms would be encouraged, but not at the expense of competition.

The most significant portion of the memo is where the Commission considers how it should apply Articles 85 and 86. In its position, the Commission asserts for the first time that there is *no logical distinction* between the control of anti-competitive behaviors and merger activity. Consequently, Treaty competition articles could, in principle, be employed to evaluate the competitive implications of merger activity. However, in drawing this conclusion the Commission argued that certain competition provisions were clearly more applicable than others.

The Commission held that Article 86 provided a firmer legal foundation for action than Article 85. Article 85, dealing as it does with restrictive *agreements*, would not be a suitable basis for actions against *acquisitions* and *takeovers*. Article 86, on the other hand, was more appropriate. In spirit, it spoke more directly to the market distorting effects of existing or acquired dominance. Although Article 86 did not explicitly address the relationship between dominance and mergers, the Commission stated that a merger between an enterprise holding a dominant position with another enterprise so that a monopoly situation is brought about may nonetheless constitute an abuse within the meaning of the Article. In so arguing, the Commission made clear that it did not believe that there was a meaningful distinction between *existing* and *acquired* dominance.¹¹

¹⁰ UA, acronym for "units of account", was the precursor to the ECU as the unit of account for Community finances. I will use each as appropriate to the period of time being discussed.

¹¹ "[I]t is immaterial whether a concentration to which a firm occupying a dominant position is a party is a result of an agreement between firms or of the acquisition of a competing firm...In so far as Article 86 can

Consequently, the Commission suggested that, on this basis, it might choose to use its authority to prevent the formation of such concentrations.

The importance of the Memo should not be overestimated. The document was, after all, a policy statement. It carried no legal force. Indeed, it was not at all clear at the time that the Commission could operationalize its articulated position. Nevertheless, the Memo signaled the first substantive effort by the Commission to actualize its long held feeling that mergers were an issue that required Community attention. It would serve, moreover, as the touchstone for the Commission as it sought fulfill its responsibility as guardian of the Treaty.¹²

iii. 1962-1970: Maintaining the Status Quo

Whatever importance one ascribes to the 1966 Memo and the increased powers enjoyed by the Commission under Regulation 17, the fact is that the Commission failed to wield any more real authority over merger activity at the end of the 1960s than it did when the decade began. The reasons for this are many. Perhaps the most important was the continued apathy (if not outright hostility) with which most member governments regarded the issue (Allen 1996). Several governments, most notable among them France, continued to hold the view that concentrations of market power, whether formed by acquisition or internal growth, should not be a concern. There was also a widely held belief that industrial concentration was needed to capture gains from scale.

This “bigness bias” received a jolt of vigorous public support with the publication of Jean-Jacques Servan-Schreiber’s highly influential 1967 book *Le Defi Americain* (The American Challenge). In this book, the author exploits a long extant current of thought in Europe that “home” markets were under assault by American multinationals. He viewed penetration of European markets as a threat to the continued health and viability of domestic industry. To counter this threat, he furthered the call for the Europeanization of industry. The regional and global competitiveness of European industry was at stake. Consequently, there was an air of tolerance of the potentially adverse effects of sectoral concentration (Cox and Watson 1995).

A second reason for the maintenance of the status quo is found in the rules and procedures governing Community decision-making. The introduction of a Community competence in merger control required a major legislative initiative. Community decision rules, however, discouraged change. Any effort to transfer merger authority to the Commission was likely subject to the procedural dictates of either Article 87 or

be applied, it covers concentrations [mergers] having equivalent economic effects without regard to their legal form” (CEC 1966: Part III, paragraph 17). The Commission continues, “[any] concentration which has the effect of monopolizing a market should be treated as an improper exploitation of a dominant position within the meaning of Article 86” (CEC 1966: Part III, paragraph 26, emphasis added).

¹² Ethan Schwartz offers an even more generous analysis of the Memo’s significance. He argues, “The memo helped convert the Treaty from a text that granted limited authority based on literal readings and original intent, into one that, through expansive reading, could be interpreted as granting broad-based, discretionary authority to govern, to make decisions, and to interpret the Treaty of Rome for the good of the European Community as a whole” (Schwartz 1993:616).

Article 235.¹³ Under either article, decisions rules held that legislation required unanimous consent from member governments. Every government, therefore, held a veto. This effectively allowed the least cooperative member government the ability to hold hostage any given proposal.

This unanimity requirement proved to be the major stumbling block. Not only did member states hold widely different attitudes toward mergers, but, by the late 1960s, several members regard with suspicion/contempt *any* legislation that sought to shift authority to supranational institutions. Championing the anti-federalist, euro-skeptical camp was French President Charles DeGaulle. In his zeal to preserve national autonomy within the Community, he provoked the so-called Empty Chair Crisis in 1965. The crisis and the Luxembourg Compromise that “resolved” the dispute, cast a pall over Community policy-making. Under the compromise, almost all decision-making would be *de facto* subject to unanimity rules. Given the unprovidential coincidence of often extreme preference diversity, the need for unanimity and the presence of one particularly anti-Community member state, it should come as no surprise that the mid- and late-1960s produced little in the way of major legislative initiatives.

C. The Commission Pushes Forward: 1970-1973

The flurry of activity in the early 1970s stands in stark contrast to the relative stasis of the late-1960s. During the first three years of the decade, Commission efforts to carve for itself a competence in merger control accelerated. It is during this period that we see the first clear evidence that the Commission was committed to a two-track strategy. On the one hand, it sought to use its extant authority to exploit ambiguities found in the competition provisions of the Treaty of Rome. The result was two landmark cases, GEMA (1971) and Continental Can (1973).

Alongside its efforts to carve a greater role in competition policy-making and merger control through the creative exploitation of *current* competencies, the Commission made clear in the early 1970s that it sought changes that would create a *new* competency. In 1973, the Commission presented the first legislative proposal addressing merger control.

i. GEMA Case (1971)

The 1971 Commission action against GEMA represents the first effort by the body to operationalize policy pronouncements offered in its 1966 Memorandum. GEMA (*Gesellschaft für musikalische Aufführungs- und mechanische Vervielfältigungsrechte*) was a German music industry trade association that acted as a clearinghouse for copyrights. Authors and composers registered their work with GEMA who then administered the collection of royalties. During the early 1970s, GEMA was a *de facto* monopoly player in the German market. In 1971, a coalition of music writers, composers and publishers, reacted to GEMA’s dominance by bringing the matter to the attention of

¹³ Article 235 is the “general provisions” clause of the Rome Treaty. It gives Community legislators a vehicle to take “appropriate measures” to fulfill Community objectives by providing a legal foundation for action.

the Commission. They claimed that GEMA's rules and restrictions coupled with its monopoly position unduly constrained their economic liberty. They sought the right, under Community law, to utilize the services of authors' rights societies throughout the Community.

The legal matter at issue in the dispute was whether GEMA, by holding a monopoly position over the distribution of music rights, abused its dominant position in violation of Article 86. To determine this, the Commission had to settle a sticky definitional matter—how to define “abuse”. While Article 86 listed a number of activities that potentially constituted “abuse,” nowhere did it make clear a set of necessary and sufficient requirements.¹⁴ In a carefully reasoned decision, the Commission argued that it was not necessary to prove that the organization had actually *exploited* its dominant position. Rather, in a provocative move, the Commission argued that the association's monopoly position *itself was sufficient to imply abuse*. On these grounds, the Commission concluded that GEMA was in violation of Article 86.¹⁵

The significance of the GEMA decision for the development of Community merger control is subtle but real. It demonstrated the degree to which the Commission could successfully bend to its will the unclear language of the Treaty of Rome. In GEMA, the Commission successfully imposed its own conception of abuse under the meaning of Article 86. It broadened the notion to include not only abusive *behaviors*, but also to changes in *market structure*. Integrating this semantic element into a definition of abuse, the Commission could in principle subject firms to Article 86 inquiries simply on the grounds that they possess substantial market power, without having to show that they actively exploited their position in an anti-competitive manner (as the “letter” of Article 86 would seem to imply). In affecting such a change in the interpretation of Community law, the Commission widened its juridical reach. While GEMA did nothing to enhance of Commission's *de jure* authority in the sense that the case did not affect the statutory rules governing competition, broadening the “spirit” of the rule to include market structure did represent a significant step forward in enhancing its *de facto* power.

ii. *1st Competition Policy Report (1972)*

In 1972, the Commission took another step to widen its influence over competition policy. It was in this year that the Commission published the inaugural volume of what would become its annual Competition Policy Report.¹⁶ The Report contained a brief synopsis of the year's activities in various areas of competition policy, including investigations undertaken against firms suspected of violating Community competition

¹⁴ For the text of Article 86, see Appendix.

¹⁵ See Commission Decision, OJ L 134, 20 June 1971. In its review of the matter, the Court largely upheld the Commission's ruling (CMLR D35).

¹⁶ In the “Introduction” to the *First Report on Competition*, the Commission notes that the impetus behind the publication of the report was a 1971 resolution adopted by the European Parliament (CEC 1972:11). In the resolution, the Parliament called on the Commission to submit an annual report on the development of competition policy. The Commission noted with pleasure the Parliament's interest and committed itself to produce an annual summary of its activities. The document would be annexed to the General Report already published annually by the Commission.

rules. The purpose of the publication was to serve as the official record of Commission activity; highlighting the Commission's legal and legislative accomplishments as well as indicating areas of concern.

In the introduction to the *First Competition Policy Report*, the Commission again communicated its competition policy vision. The document called on Community institutions to pursue a vigorous competition policy. In a tone reminiscent of the 1966 Memorandum, the Commission made special light of the particular threat posed by firm actions that have the effect of undermining competitive market structures:

With regard to rules of competition applicable to enterprises, the Community's policy must, in the first place, prevent governmental restrictions and barriers—which have been abolished—from being replaced by similar measures of a private nature...Moreover competition policy must ensure fair competition so that enterprises operating within the Common Market can, in general, benefit from the same conditions of competition (CEC 1972:13).

The Commission viewed competition not only as a desirable end to pursue, but also a means to see that the objectives of the Treaty were attained (Mathijsen 1995:215). Whereas Articles 85 and 86 served a legitimating role as the legal basis of Commission actions, the GEMA decision was indicative of the broader policy ethos it intended to pursue. The notion of "competition" was increasingly being interpreted to include the maintenance of competitive markets structures.

It would be misleading to give the impression that only the Commission was interested in pursuing actively pushing the competition dimension during these years. In fact, member governments also recognized the dangers of excessive concentrations of market power. They came to the realization that perhaps there was a need for some type of common merger policy. In the final communiqué issued from their 1972 Paris Summit, Member governments made their first formal statement in support of collective progress on this front:

The Heads of State or of Government consider it necessary to seek to establish a single industrial base for the Community as a whole. This involves...the formulation of measures to ensure that mergers affecting firms established in the Community are in harmony with the economic and social aims of the Community and the maintenance of fair competition as much within the Common Market as in external markets in conformity with the rules laid down by the Treaty (quoted in CEC 1974:29).

While the communiqué suggested that member states were agreed in principle to a Community-based approach to merger control, no suggestions were offered about the appropriate means to this end. This is no doubt connected to the fact that members continued to differ widely on the appropriate scope of merger control. In 1972, West Germany remained the only member state with a developed domestic competition policy regime. France, Italy and the Benelux countries had few laws that addressed directly anti-competitive firm behaviors, and even fewer that addressed the question of mergers. These existing divisions among the EEC(6) were only to be exacerbated by the diversity of legal and philosophical approaches espoused by the four countries (the United Kingdom, Ireland, Denmark and Norway) who were nearing the end of accession

negotiations.¹⁷

Political and philosophical differences among member governments notwithstanding, the Commission continued to push its agenda. If GEMA represented the first Commission's first effort to solidify and expand its legal identity in competition policy, the Competition Policy Report was to have the symbolic value of acting as the public chronicle these efforts.

iii. Continental Can (1972-3)

With a renewed determination to carve-out for itself additional powers in the field of merger control, the Commission looked for an appropriate test case. GEMA, while significant as the first attempt by the Commission to assert its legal identity, did not represent a radical move forward. The Commission wanted a case that would truly test the bounds of its authority and to do so in a dispute explicitly involving merger activity (Goyder 1993:387). They found such a case in the now famous Continental Can dispute.

Continental Can Company was a New York-based manufacturer of metal cans and other packaging materials. Through its wholly-owned Belgian subsidiary, *Europemballage Corporation SA*, Continental Can acquired the largest German producer of packaging materials *Schmalbach-Lubeca-Werke AG (SLW)*. As a consequence, Continental Can became the dominant player in the German market. Soon thereafter, Continental Can sought majority control the dominant producer of packaging in the Benelux countries, Dutch holding company *Thomassen & Drijver-Verblifa NV (TDV)*.

Upon learning of Continental Can's plan to acquire TDV, the Commission warned Continental Can that its actions raised questions under Article 86. In a written notice on the matter, the Commission considered Continental Can to hold a dominant position in the German market. The Commission further noted that they believed that Continental Can was abusing this dominant position by seeking to control TDV, since it was a major competitor in a neighboring market. Should the acquisition be allowed to stand, the Commission argued that Continental Can would shortly come to hold a dominant position in a substantial part of the common market.

The notice of concern went unheeded. Continental Can and Europemballage undertook the acquisition anyway. Consequently, the Commission decided to use powers granted under Article 3 of Regulation 17 to initiate formal legal proceedings. Consistent with the position outlined in the notice, the Commission held that Continental Can was abusing its already dominant position by acquiring one of its few potential competitors.¹⁸ This would have the effect of strengthening its own dominant position in such a manner as to practically eliminate competition in Community markets. Moreover, the acquisition of a potential competitor by a dominant enterprise would result in an irreversible change in the supply structure, since a return to a competitive situation between the firms in a

¹⁷ Norway never completed the process. The Norwegian electorate voted down membership in a 1974 national referendum.

¹⁸ 1972 CMLR D11

market would become impossible. On these grounds, the Commission sought to “end the infringement” by obliging Continental Can to discontinue the breach of Article 86. They ordered Continental Can to submit a proposal outlining actions it would take to remedy the violation.

Continental Can appealed the decision to the ECJ under Article 173 of the Rome Treaty.¹⁹ Continental Can held *inter alia* that Article 86 applied only to abusive behaviors that directly affected consumers, not merely a structural change in the market.²⁰ The acquisition of TDV itself evinced no change in consumer welfare and therefore should not be regarded as *per se* incompatible with the common market. In effect, Continental Can held that the standard laid down in GEMA was in error.

In its decision, the ECJ upheld the Commission’s reasoning while simultaneously rejecting the decision on the facts of the case.²¹ The ECJ annulled the Commission’s decision and allowed the acquisition of TDV to stand. However, in its ruling the Court also made clear that expansion of dominant position *was* sufficient grounds for the application of Article 86.²² This meant that the Commission was free to scrutinize mergers that threatened to create firms with a dominant position, even though the resulting firm may not evince any actual abuse. Thus, while the Commission lost the skirmish, it won the battle. As such the outcome can be seen as another clear step forward in the Commission’s efforts to widen its competence over merger control (Bulmer 1994, Allen 1996).

iv. The 1973 Draft Regulation

As noted above, the Commission’s strategy to pursue greater leverage over merger control traveled two tracks. The first track, illustrated by GEMA and Continental Can, revealed the Commission’s effort to exploit *extant* legal competencies. The Commission, however, also sought to enhance its authority by seeking *new* legal authority through legislative action. The Commission would use its influence over the Community legislative process to push for changes in EC law. The first substantive effort to seek a formal expansion of its competence over mergers was its 1973 Merger Proposal.

¹⁹ Notably, no member government actively opposed the Commission’s decision.

²⁰ The interesting thing to note about this case is that the Commission did not bring evidence to bare indicating that Continental Can had actually “abused” its position in the marketplace. In fact, there was no evidence that consumer welfare had been damaged by Continental Can’s monopolistic behavior. Rather, the case against Continental Can revolved around the *acquisition* of a competitor. The Commission reasoned that Article 86 prohibitions applied not only to company abuses *ex post facto*, but the underlying logic applied with equal force to the preservation *ex ante* of competitive market structures. Continental Can was guilty of abuse by attempting to strengthen its already dominant position *by means of a merger*—the effect of which would be to reduce further competition in the common market. The Commission argued that a dominant firm that furthers its market power through merger or acquisition could be guilty of “abuse”.

²¹ *Europemballage Corporation and Continental Can Company Inc. v. EC Commission* 1973 CMLR 199

²² Significantly, the Court linked the Commission’s broad reading of Article 86 with the general competition objectives laid down in Article 3(f). In so doing, the Court was, in effect, holding that the Commission would be within its jurisdiction to evaluate a wide range of activities of dominant firms that had as their intent or effect the undermining of competition in the common market.

In July of 1973, the Commission offered a draft merger regulation to the Council for its consideration.²³ In the *First Report on Competition* published the same year, the Commission had argued that a sizeable increase in cross-border mergers was underway.²⁴ Legislation was therefore needed to ensure the maintenance of competitive market structures. This, continued the Commission, was all the more important following the recent (1968) completion of the customs union. Noted the Commission,

“It is incontrovertible that the process of industrial concentration is on the increase...the Commission cannot overlook that the EEC Treaty, in making it responsible for applying the rules on competition, requires it to preserve the unity of the Common Market, to ensure that the market remains open and ensure effective competition. *Excessive* concentration is likely to obstruct these aims...The legal instruments in the field of competition law currently available do not give adequate means of dealing effectively with the dangers arising from excessive concentration” (CEC 1974:28-9, emphasis original).

The Commission noted that the concentration of market power in some sectors was such that the number of firms in some industries has dropped markedly, sometimes by as much as half. In some industries, the four largest firms control between 80% and 90% of sales or production (CEC 1974:31). Thus, to the extent that mergers allow firms to reach or consolidate a dominant market position, they wield the monopolistic power to act as a price-setter rather than price-taker (as is the norm in a competitive market structure). Potential competitors would be driven out and consumers would suffer a deadweight welfare loss. The Commission reasoned that proposed Merger Regulation would provide the legal tools required to ensure that Community markets remained competitive.

The proposal had three main elements. The first concerned the *scope* of merger control. The reach of merger control legislation was to be extensive. In principle, *all* mergers involving Community firms would be subject to review. The Commission, however, included three derogations from this requirement. First, A merger valued at less than UA 200 million would not be subject to approval. Also excluded from the ambit of Community control would be mergers that resulted in a firm having less than a 25% market share in any given member state. These two exemptions ensured that member state authorities retained control over those transactions having primarily a national character.²⁵

The third exemption applied to specific industrial sectors regarded as special. Mergers

²³ Proposal for a Regulation (EEC) of the Council on the Control of Concentrations between Undertakings, submitted to the Council by the Commission on 20 July 1973 (OJ C92 1, 31 October 1973).

²⁴ According to Commission figures the annual number of mergers in the EC(6) had grown over threefold between 1962 and 1970, from 173 to 612. Moreover, the rate of increase between 1966 and 1970 was almost double that between 1962 and 1966 (CEC 1974:30).

²⁵ The regulation also included a notification requirement for mergers involving especially large companies. Mergers creating a company whose aggregate turnover exceeded UA 1 billion, or any merger that involved a company whose annual turnover exceeded UA 1 billion, would be obliged to notify the Commission before proceeding with the transaction. This notification requirement even applied to purely national mergers when it could be shown that the merger in question would affect trade among member states.

having clear anticompetitive consequences may nonetheless be approved where the transaction could be shown to be “indispensable to the attainment of an objective which is given priority treatment in the common interest of the Community.”²⁶ Presumably, this clause was included to provide the regulatory leeway necessary for governments to deal with industries such as shipbuilding or motor vehicles, whose value-added to the Community extended beyond the level of price competition exhibited in Community markets.

The proposal also included language that set forth the criteria to be used when evaluating the compatibility of a merger with the common market. Making explicit reference to Article 3(f) of the Treaty of Rome wherein the Community is directed to institute “a system ensuring that competition in the common market is not distorted,” the Commission proposed criteria rooted in market principles (as opposed to criteria integrating concerns for social or regional development). Consistent with the precedent set forth in *Continental Can*, mergers would be evaluated against the level of “effective competition” that was likely to prevail in Community markets in the presence of the new firm.²⁷ Firms that are seen to acquire or enhance their power so as to hinder effective competition would be regarded as incompatible with the common market. In this way, the criteria conformed to the underlying *laissez faire* bias already implicit in the construction of a common market.

The third element of the proposal outlined measures regarding the administration and enforcement of merger control. The central feature of this part of the proposal was provisions that gave the Commission exclusive authority to evaluate mergers. Where the Commission concluded that a merger would be incompatible with the common market, it would have the power to request changes or issue an outright ban. To ensure that decisions handed down by the Commission would be heeded, the proposal also contained a clause giving the Commission the authority to penalize noncompliance. Firms that failed to comply with a decision to prohibit or amend a transaction were subject to fines up to UA 1 million.

Council deliberations commenced shortly after receipt of the proposal.²⁸ It was clear early in the process, however, that the required unanimity was not forthcoming.²⁹

²⁶ It is interesting to note that the provisions of the proposed merger regulation reflect political sensibilities closer to those embodied in the Community’s policy against restrictive practices (Article 85) than its monopoly policy (Article 86). Like Article 85, the proposed regulation allowed for specific exemptions from the general prohibition of anti-competitive mergers. Indeed, as George and Joll (1975:28) note, the “grounds for exemption were wider and vaguer” than those listed in Article 85(2). They go on to suggest that this was a pragmatic move on the part of the Commission. Given the Community’s general ambivalence towards mergers in the past, the authors suggest that it would very difficult to forward a law that pushed for outright prohibitions.

²⁷ Factors to be taken into account in assessing a merger included the economic and financial power of the firms involved, market structures and the scope for choice available to suppliers and consumers.

²⁸ Consistent with Community procedure, the proposal was also considered by the European Parliament and the Economic and Social Committee (EcoSoc). For their respective opinions on the legislation, see OJ C 23, 8 March 1974 and OJ C 88, 26 July 1974.

²⁹ Procedurally, the proposal required unanimity in the Council because the regulation was offered under Articles 87 and 235 of the Rome Treaty. Reference to Article 235 was necessary because the powers

Member governments could not reach agreement on two key provisions. First, governments differed over the appropriate scope of the regulation. French, Italian and British representatives opposed the introduction of a Community-based policy regime on the grounds that it would dilute national authority, thereby undermining the ability of governments to use mergers to pursue industrial or social policy goals. For instance, the French government recognized that its *dirigiste* tradition of close industry-government relations and indicative planning was at odds with a proposal that created a Community merger policy grounded efficiency-based competition criteria. The specific derogations mentioned in the proposal notwithstanding, French and Italian authorities demanded changes that would explicitly integrate industrial policy considerations into the legislation's evaluative criteria (Wullaerts et al, 1988:281). The British also opposed the draft regulation. They held that the regulation did not have sufficient safeguards for matters of public interest. Britain, unlike France and Italy, had a domestic legal structure in place to govern merger control. However, British merger law did not put sole emphasis on competition as an inherently desirable objective. Unlike the Commission's proposed law, British competition authorities could also consider whether a merger had a "public interest" dimension—to wit, that a merger might further some wider social, regional or industrial goal. While the Commission did include a diluted public interest clause in the proposal, the British resisted ceding domestic authority. They were particularly reluctant since there was no clear evidence that the competition effects of cross-border concentrations were of sufficient importance to require Community legislation (Bulmer 1994:429).

Germany, Denmark, Ireland and the Benelux countries, by contrast, generally supported the idea of a Community-level merger policy. The reasons for their support, however, differed. The Germans were comfortable with the merger regulation as drafted by the Commission since it closely mirrored the political and economic philosophy prevailing in German competition law (Woolcock 1989). The Germans were pleased that mergers would be evaluated against pure competition criteria. They also liked the notion of a "one-stop shop" for merger control. The German government felt that its highly competitive firms—those most likely to be covered by the Regulation—would benefit from a single Community-wide approval system that supplanted multiple domestic jurisdictions. While the smaller countries followed Germany in supporting the principle of a single merger policy, their support should be seen as largely a pro-integrationist gesture. Few Irish or Benelux firms would be affected since almost no companies were of sufficient size to trigger Commission review.

The second provision over which member states differed was the distribution of administrative and enforcement authority between national authorities and Community institutions. Perhaps the most controversial provision was the one which gave sole decision authority to the Commission. Under the proposed regulation, the Commission would have investigative, decision-making and sanctioning powers similar to those it possessed under Regulation 17. Member governments, consequently, would be only marginally involved in the process. The merger proposal provided for an Advisory

Committee comprised of member state representatives. The authority of this body, however, would be negligible. While the Commission would be required to consult member governments before taking action, the opinion of the committee would carry no binding force.³⁰ Observed one analyst, “the Commission [would act] at the same time as investigator, prosecutor and decision-maker” (Markert 1976:86).

Member state support for this set of provisions fell along lines similar to those regarding the regulation’s scope. Germany, Denmark and the Benelux countries supported the Commission’s call for decision independence (Wullaerts et al, 1988:624). They were wary of giving member states a voice, lest political considerations undermine the process. They feared that governments might attempt to manipulate the decision-making process to the benefit of domestic firms. France and Italy, on the other hand, opposed transferring sole authority to the Commission. They feared that the Commission might render decisions that would harm vital domestic industries. Britain also resisted. The British government already possessed a domestic legal framework for the evaluation of mergers and, consequently, it had no desire to transfer sovereign control lock-stock-and-barrel to the Commission.

In sum, the 1973 draft regulation failed because there was insufficient support among the member states in the Council to secure the unanimous consent necessitated by the prevailing voting rule. The vote failed primarily because member state attitudes diverged on two issues. First, member states disagreed over the scope of the Regulation. Second, they disagreed over the degree of autonomy the Commission should enjoy. Despite the failure, the Commission did not relent. The Commission continued to hold fast to its desire for a Community merger control regime. The failure did not lessen the Commission’s resolve, but it forced the Commission officials to recognize that if merger control was to become a reality, either they would have to modify the proposal to reconcile divisions among member governments, or member state preferences themselves would have to change.

D. Stasis: 1974-1985

The 1973-1974 oil shock and resulting deterioration in global economic health had a profound effect on Europe. Sky-rocketing oil prices triggered a recession. Output fell and unemployment rose. The economic pie not only stopped growing, but for the first time since 1947, it began to shrink. To make a bad situation worse, by the latter half of the decade, recession would give way to stagflation. Negative growth rates coupled with accelerating prices to further retarded economic growth, leading to a disarming upsurge in unemployment.

During the economic downturn of the mid- to late-1970s, the spirit of optimism and cooperation characteristic of the early years of the EEC began to atrophy. States looked increasingly inward for solutions to economic stagnation (Cox 1982). Governments felt pressure from domestic constituencies to protect national economic resources, even if it

³⁰ The member states could, however, challenge a Commission decision before the Court under Article 173(1) for violation of the Treaty or for abuse of discretionary power.

meant compromising the gains of years past. Progress toward integration alone was no longer viewed as an adequate means to economic prosperity.

Indicative of these shifting priorities was the uptick in the appearance of non-market competitive structures. Member governments already known for their policy of encouraging “national champions” pushed these policies with increased vigor. Particularly disturbing, however, was the fact that even governments whose more laissez faire orientation had precluded recourse to wide-scale subsidization and protection in the past, found themselves pressured to employ just such measures to buoy employment. These domestic policies had deleterious regional consequences. Efforts to preserve domestic capacity served only to create massive surplus capacities at the regional level. Significant productive overcapacity appeared in traditionally powerful sectors like steel, shipbuilding and textiles (Tsoukalis and da Silva Ferreira 1980). What was worse, Member government who before agreed to work with one another to achieve common goals began to view the system in beggar-thy-neighbor terms.

During these years, the Commission found itself in a difficult position. On the one hand, there was pressure from some quarters it to enforce competition laws aggressively. The belief being that this would serve to spur growth and maintain what little momentum remained in the integration project. On the other hand, the Commission recognized that there would be little support, and perhaps a great deal of outright hostility, to aggressive enforcement of competition policy rules.

i. Crisis Management

The Commission response during this era reflected a pragmatic effort to fulfill its mandate while simultaneously minimizing the political risks. The Commission reached out to member states’ most pressing needs. The Commission permitted the creation crisis cartels in steel and synthetic fibers, even though it knew the existence of these cartels would be in outright violation of market sharing prohibitions under Article 85 (Joliet 1981).³¹ The Commission reduced the stringency with which it pursued the provision of state aids to other threatened sectors, such as shipbuilding and automobiles.³² Also, in an effort to encourage general restructuring of Europe’s economic base, the Commission viewed favorably state aids granted to promote sunrise technologies in telecommunications, computers, etc. The Commission hoped that these measures would provide the breathing space necessary to facilitate industrial modernization and restructuring.³³

Although the competition police in DG IV pursued their charge with less vigor, they did not suspend enforcement efforts altogether. Despite the political imperatives requiring

³¹ Notes Allen, “the Commission [found] itself constantly forced to circumnavigate (sic) the Treaty as part of its effort to keep some form of participation in the management and directing of the European economy” (1983:213).

³² See Commission’s Eighth-Tenth Competition Policy Reports.

³³ For informative overviews of the crisis atmosphere of the late-1970s and the measures taken by the Commission, see Tsoukalis and da Silva Ferreira (1980) and Kirchner (1982).

the Commission to pare back its activities, the Commission wanted to ensure that it would continue to be taken seriously as a significant actor.³⁴ To this end, the Commission aggressively enforced competition provision a limited number of cases where firm behavior was clearly at odds with Commission rules. Among the more visible decisions was a 1979 fine of ECU 6.96 million levied against *Pioneer Electronics Europe N.V.* and its distributors for collusive practices (CEC 1980).

ii. The 1981 Draft Regulation

Perhaps paradoxically given the unpleasant economic and political environment within which the Commission found itself notwithstanding, the Commission undertook a bold move in 1981 to revive its call for a Community merger regulation. On December 16, the Commission submitted to the Council a revised draft of the 1973 proposal (OJ C36, 12 February 1982). In it, the Commission sought to mollify some of the concerns expressed by opponents of the earlier proposal. For instance, the scope of the regulation was narrowed. It was rewritten to address more clearly mergers having a significant Community dimension. A merger would fall within the jurisdiction of Community authorities only where the aggregated turnover of participant companies exceeded UA 500 million (formerly 200 million) and Community-wide market share was projected to exceed 20 percent.

While the Commission narrowed the scope of the regulation, it chose not to change appreciably provisions that distributed administrative authority. The Commission would continue to be the paramount enforcement authority. The role for the Advisory Committee was altered somewhat from the 1973 proposal. The committee would have the power only to delay Commission action for twenty days, but it would still have no authority to veto or alter a Commission decision.

Again, member governments in the Council were unable to muster the unanimity necessary to enact the legislation (Allen 1983). Differences fell along familiar lines. Germany, and the small countries generally supported the proposal, while France, Italy and Britain continued to oppose it. Efforts to narrow the scope of the regulation, while favorably received, were not enough to win over reluctant governments. Also, Britain and France continued to chafe at the notion that the Commission would exercise sole authority. They demanded a beefed-up Advisory Committee procedure—one that would give member governments the ability to influence Commission decision-making, not merely delay the implementation of decisions already taken. France and Italy also

³⁴ Note the following statement by the Commission regarding the continued importance of competition policy,

Competition policy overall must constantly endeavor to integrate and harmonize inevitable public intervention with the action needed to ensure that effective competition remains the economy's principal regulating force. The contribution made by a system of undistorted competition framed in this way and applied to the extensive area covered by the common market is essential if the Community is to adjust to present-day economic demands and wage the battle, now more imperative than ever...Only by sparing no effort to maintain and, if necessary, restore this competitiveness...will high and stable employment be ensured throughout the common market (CEC1981: 11).

continued to oppose the use of pure competition criteria. They insisted that the Commission integrate a more expansive public interest dimension (something the Germans and the Benelux countries avowedly resisted).

E. Winds of Change: 1985-1988

Beginning in the early-1980s, the economic and political environment within the European Community began to change. In the five years between 1979 and 1985, Community membership rose to ten with the addition of Greece; a long-awaited monetary identity for Europe was realized with the introduction of the European Monetary System; and the European Parliament was directly elected for the first time. The early 1980s also saw a sea-change in the political economies of individual countries. In Great Britain, recently elected Prime Minister Margaret Thatcher began a drive to deregulate and liberalize large swaths of the British economy. And in France, the failure of the Mitterand experiment of 1981-82 marked a transformation in French attitudes toward the growing neoliberal moment spreading across Europe. Market remedies were increasingly seen as the means of resolving Europe's ills and ensuring its future prosperity. Perhaps there is no better indication of this change than the ratification of the Single European Act.

i. The Single European Act

The Single European Act (SEA) proved a critical impetus for the further development of Community merger control. The core of the SEA was the internal market project, popularly known as Project 1992. Based on the nearly 300 proposals outlined in a 1985 Commission White Paper entitled, *Completing the Internal Market*, the single market project called for the removal of remaining non-tariff barriers among member states. It was to be an unprecedented exercise in deregulation and market liberalization. Member governments embarked on this project in part under the belief that the introduction of market forces into sectors hitherto shielded from competition would yield greater efficiencies, technological progress and improved overall competitiveness for European firms both at home and abroad. As such, the project very much reflected the economic zeitgeist spreading through Western countries. It was estimated that full implementation of the internal market would contribute 5-7% to Community GDP (Cecchini 1988).

Although the SEA did not directly address the question of merger policy, the White Paper made clear that strengthened antitrust enforcement was a necessary concomitant to liberalization: "As the Community moves to complete the Internal Market, it will be necessary to ensure that anti-competitive practices do not engender new forms of local protectionism which would only lead to a re-partitioning of the market" (CEC 1985:39-40). Community analysts reckoned that nearly half of the economic benefits of liberalization would be realized through industrial restructuring. Deregulation, combined with the opportunities to capture economies of scale, would lead to a massive upsurge in trans-European mergers, acquisitions and joint ventures. The anticipated rise in the scale of business raised concern in some quarters that the resulting market consolidations would result in some transactions whose effect would be decidedly anticompetitive.

There was a real threat that the public barriers laid bare by liberalization would soon be replaced by private barriers erected by companies who wished either to shield themselves from competition or to exploit their dominant position. If market remedies were to lead to Europe's revival, then competition policy would have to be an active element in this effort.

The Commission was not alone in recognizing the potential impact of the single market. It was also clear to member governments that the process initiated by the SEA would have the effect of transferring a great deal of *de facto* control over the direction and pace of liberalization to Community institutions. Among other things, the removal of liberalization of markets and the Europeanization of industry promised to raise thorny jurisdictional questions. From the perspective of member governments, the Community would need more effective instruments of coordination than currently existed.

That this was so was amply illustrated in the question of mergers. For all the emphasis placed on deregulation, firms with large cross-border interests encountered widely different regulatory regimes. Concurrent jurisdictions led to a regulatory nightmare for business; multinational firms wishing to exploit the opportunities presented by the single market might find their behavior encouraged in one country while simultaneously receiving sanction in another. In fact, it was theoretically possible for a firm to be fined twice, once by national competition authorities and again by the Commission. Even those member governments who hitherto resisted calls for a Community-wide merger regime recognized that it would be clearly contradictory to the principle of free markets to have widely different systems and levels of merger control within the Community with some members having strict control provisions and others having none at all.

The SEA has a significance beyond the anticipated impact of completing the single market project. *Institutional changes* called-for under the SEA also promised to affect the prospects for a merger regulation. Perhaps the most significant change was the commitment by member states to increase the use of qualified majority voting in the Council. This promised to break one of the enduring impediments to Community decision making. At least in theory, the Commission would no longer have to cast legislative proposals with an eye to the lowest common denominator.

Against this dual background of economic and institutional change, competition mandarins in the Commission saw this as an opportunity to again press their case for some sort of Community-level merger control. Mr. Peter Sutherland, Commissioner responsible for DG IV between 1985 and 1988, led the charge. In a speech to national Ministers of Competition he remarked,

Let me now address a major issue which is a pre-occupation of the Commission and will become even more so in the coming months: the old but nevertheless currently increasingly important question of a European system of merger control and authorization. This is not merely a question concerning traditional competition policy; a Community-wide merger regulation is now a vital instrument in achieving a single integrated market by 1992.³⁵

³⁵ Speech given in July 1987 as quoted in Wullaerts, et al (1988:289).

Sutherland, to further emphasize his point, cited a report commissioned by the Commission that regarded the introduction of a Community-based merger regime as “indispensable” if the internal market project was to succeed.³⁶

The Commission also made it very clear to member governments that if legislative progress on a Community merger regulation was not forthcoming, it would continue to push the interpretation of competition articles to develop *de facto* what governments were resistant to provide *de jure* (Goyder 1993:391).³⁷ Sutherland made regular public statements to this effect:

As I have already indicated on other occasions, if the proposal for merger control which has been pending now before the Council for twelve years is not enacted, the Commission will be forced to examine the direct applicability of Articles 85, 86 and 90 to mergers (Wullaerts et al, 1988:286).

Sutherland also used his public statements as a fora for intimating a new direction in the Commission’s legislative strategy. As if to threaten reluctant countries, Sutherland stated on more than one occasion that he would begin to look for a Treaty basis for merger control that would not be held hostage to one or two reluctant members. Stated Sutherland,

If there is no prospect of progress the Commission must envisage alternative means of achieving Community-wide merger control. There are a number of options available. One is a regulation based on Article 87 concerning the applications of Articles 85 and 86 to mergers which would only require a qualified majority in the Council (Wullaerts et al, 1988:286).

What his predecessors could not accomplish by unanimity, he would seek to secure by qualified majority.

In 1987, The Commission’s cause received a dramatic and unexpected boost. In November of that year, the ECJ handed down a ruling on a long-simmering row in the tobacco sector between the Commission and Philip Morris. In its decision, the Court intimated for the first time that Article 85, long held by the Commission as an inappropriate tool of merger control, might nevertheless be used for just that purpose. The impact of this decision proved far reaching.

ii. Philip Morris-Rothmans

In the 1966 Memorandum, the Commission argued that only Article 86 among the Treaty competition articles, provided a firm foundation on which to build a Community merger policy. Article 85, by contrast, was ill-suited to such a role for its application risked being over-inclusive. The strict criteria of Article 85(1) would preclude too many mergers that the Commission might otherwise find desirable. On that basis, the

³⁶ The report Sutherland cites is Padoa-Schioppa (1987).

³⁷ Dubbed the “little Sheriff” by Commission President Jacques Delors, Commissioner Sutherland took full advantage of the single market program to enforce competition rules. For instance, in 1986, the Commission imposed fines of ECU 57 million on a group of fifteen petrochemical companies determined to be in violation of Community rules against price fixing and market sharing (OJ L230, 18 August 1986). This single fine exceeded the total value of penalties issued the preceding year.

Commission held the position from it did not intend to use Article 85 as a means to expand its competence over mergers.

By the mid-1980s, the Commission reversed its position. Frustrated by the lack of progress on merger proposals, Peter Sutherland and others in the Commission began to argue that Article 85 might indeed apply to acquisitions under certain limited conditions. His efforts were given a boost by the outcome of the Philip Morris case.

In 1981, American tobacco giant Philip Morris announced its intention to purchase a fifty percent equity stake in Rothmans Tobacco—an erstwhile competitor—from Rembrandt Group Ltd., a South African holding company.³⁸ Part of the deal was that both sides agreed they would jointly manage the day-to-day activities of Rothmans. The companies, anticipating that the transaction may raise regulatory questions under Article 85, notified the Commission (in compliance with their duty under Regulation 17). They hoped the Commission would be favorably disposed to grant the transaction an exemption under Article 85(3).³⁹

The Commission was reluctant. Competition officials were concerned, in particular, with plans to manage the company jointly. To make matters worse for Philip Morris/Rembrandt, two of Philip Morris' chief rivals, RJ Reynolds and British American Tobacco (BAT), weighed in on the matter. RJ Reynolds and BAT claimed that to allow Phillip Morris a controlling interest in Rothmans would, in effect, allow it to influence market conditions in the European tobacco market. The resulting distortion of competition would clearly violate enumerated prohibitions in Article 85(1) without contributing positively to either production/distribution or technological progress. The Commission, after considering the matter, issued a decision wherein it effectively sided with Reynolds and BAT. The Commission issued an injunction blocking the transaction.

Phillip Morris, in an effort to secure Commission approval, offered to amend the terms of the deal. It wanted to assure a skeptical Commission that it would have neither board representation nor managerial influence. Philip Morris reshaped the deal so that it would control only a 24.9 percent voting share in Rothmans. Moreover, it would leave Rembrandt in total control of the day-to-day management of the company. The Commission, satisfied with the amended deal, granted Philip Morris the exemption it sought in 1984.

This, however, would not be the final word on matter. As soon as the Commission decided to grant the exemption, RJ Reynolds and BAT lodged a complaint against the Commission with the ECJ to have the exemption overturned. The firms again pushed their claim that the acquisition would allow Philip Morris powerful leverage of

³⁸ For an extended discussion of the Philip Morris case and the implications the case had for merger control, see Wullaerts, et al (1988: 263-279).

³⁹ Section 3 of Article 85 held that an agreement that might otherwise be illegal may nonetheless be allowed to stand if the resulting firm can show evidence that it would improve the production or distribution of goods or promoted technological progress in the Community while at the same time affording consumers a share of the benefits.

Rothmans, notwithstanding emendations to the deal. They argued that Philip Morris might, among other things, use its privileged position to seek control of Rothmans in the future, thereby accomplishing by stealth what it could not secure overtly.

The Court, unconvinced by the argument presented by RJ Reynolds/BAT, ruled in favor of the Commission/Philip Morris.⁴⁰ The Court held that the acquisition of an equity interest in a competition did not of itself restrict competition. Thus, Philip Morris was free to invest in Rothmans. However, the Court did not stop there. In a ruling whose importance to the story of merger control is rivaled only by the *Continental Can* case, the Court argued that while acquisitions of equity interest did not constitute *prima fascia* evidence of anticompetitive behavior, such acquisitions *might nonetheless serve as an instrument to that end*. By stressing a test of “legal or de facto control” and reaffirming the Commission’s authority to evaluate transactions falling within the ambit of Article 85, the Court came extremely close to declaring outright that Article 85 could in fact be used to evaluate mergers and acquisitions (Wullaerts et al, 1988:274). The upshot of the decision was that the Commission no longer was forced to prove “dominance” - as it did to employ Article 86 prohibitions - it had only to show that a takeover might be carried out with the intention of reducing effective competition.

The impact of *Philip Morris* was immediate and significant. Commissioner Sutherland and DG IV used the decision as a springboard to further flex the Commission’s regulatory muscle. In early 1988, the Commission demanded and won changes in two high profile mergers: the takeover of British Caledonia by British Airways, and the acquisition of Irish Distillers Group (IDG) by a consortium of British beverage producers. In the British Airways case, the Commission won changes in the terms of the merger, this despite the fact that British competition authorities had already approved the deal. In the Irish Distillers case, the Commission forbade the acquisition of IDG by a holding company formed by Allied-Lyons, Guinness and Grand Metropolitan on the grounds that the consortium had been formed specifically to prevent more competitive bids and that the acquisition, were it allowed to proceed, would increase the acquiring firms’ already dominant position.⁴¹

In light of the *Philip Morris* decision and the rapidly accelerating rate of merger activity in the Community, the politics of merger control changed considerably. For instance, business interests increasingly coalesced behind the idea of a single Community merger regime (Woolcock 1989, Bulmer 1994).⁴² The degree of dissatisfaction with the status quo was summarized by Heinz Kroger, head of company affairs to the federation of European employers (UNICE), “We have the worst of all worlds at the moment—narrow

⁴⁰ This case is alternately described as the Philip Morris case or the RJ Reynolds/BAT case. The Commission and most commentators refer to it as Philip Morris. However, one might find that it is referred to as RJ Reynolds/BAT; the reason being that the Court decision settling the case was initiated by these actors (*BAT and RJ Reynolds v Commission* [1988]).

⁴¹ For summary details of both cases, see the *XVIII Report on Competition* (CEC 1989)

⁴² Bulmer (1994:432) suggests that the uncertainty created the Commission activity contributed to the creation of an “unstoppable alliance” of Commission officials, industry actors and the Court. While this perhaps overstates the case, Bulmer is correct to highlight the degree of preference consonance among these actors.

national controls supplemented by a Community control where nobody knows which criteria apply. The sooner we get the regulation the better” (Financial Times, 20 December 1988:20). Industry desired a degree of legal certainty and procedural predictability. They were keen to avoid the hazards posed by multiple concurrent jurisdictions, where national competition authorities in one country might approve a deal only to be countermanded by regulators in another member state. This situation was only made worse by the increased assertiveness of the Commission.

Member states, even those who were wary of Commission activism, also increasingly came to view the prevailing state of affairs as untenable.⁴³ The same procedural uncertainties that concerned business interests influenced the thinking of member governments. As Goyder notes, “Possibly...the most important outcome of the case from the Commission’s viewpoint was its likely effect in concentrating the minds of the more unwilling Member States, fearful of the use of the *Philip Morris* precedent to attack mergers under Article 85” (1993:392). A regulation specifically addressing merger activity would at the very least allow governments to reassert some measure of control over the course of events. With it, they could clarify jurisdictional questions and substantive standards. Without it, uncertainty would prevail. Progress seemed to be in the offing.

iii. The 1988 Draft Regulation

The Philip Morris judgment was handed down in November 1987. Five months later, in April of 1988, the Commission submitted a new draft merger regulation to the Council for consideration.⁴⁴ The proposal embodied some notable changes from earlier efforts. In a departure from the ethos of the earlier proposals, where all mergers were to be subject to Community control *unless they fell below* a certain threshold, the new draft held that mergers would be considered exempt *unless they exceeded* some minimum threshold. Only mergers between undertakings having at least ECU1 billion aggregate world turnover were subject to review (five times the value stipulated in the 1973 proposal).⁴⁵ Moreover, mergers, whatever their size, were excluded from review if more than 75% of the aggregate EC-wide annual turnover of the resulting firm occurred in a single member state. Where such a geographical concentration existed, the mergers would be the exclusive jurisdiction of the relevant member state. Finally, the draft regulation considered all mergers not subject to review under the above conditions to be beyond the

⁴³ As Allen observed, “By a combination of luck and skill the Commission had managed to create a problem which the Council felt it could be eased only by passing the legislation it had previously refused to (seriously) consider” (1996:171).

⁴⁴ OJ C130, 19 May 1988. Actually, between the 1981 proposal and the one offered in 1988, the Commission floated two slightly amended versions of a merger regulation past the Council: one in 1984 and a second in 1986. Because the changes offered in these proposals were quite minor, neither represented enough of an advance on the 1981 effort to warrant any shift in support within the Council. Consequently, they were both dead on arrival. For the text of the amended proposals, see OJ C51, 23 February 1984, and OJ C324, 17 December 1986.

⁴⁵ According to the draft, mergers involving a firm whose worldwide turnover exceeded ECU 1 billion might nonetheless be exempt if the firm being targeted has less than ECU 50 million in worldwide turnover.

reach of the regulation if the merger resulted in a firm whose Community market share would be less than 20 percent.

Despite the almost universal recognition by member governments that some progress was necessary on merger control, the proposal again received a lukewarm reception. As in the past, government concerns focused on three issues. First, members still differed over the scope of the draft regulation (*Financial Times*, 20 December 1988:20). Britain, Germany and France desired higher thresholds. They sought to ensure that only the largest and most potentially market distorting mergers fell under Community control, since these countries held a disproportionate share of the firms most likely to be covered by any regulation.⁴⁶ Notwithstanding the fact that the ECU 1 billion threshold was already several times higher than the 1973 proposal, Britain and Germany urged that it be raised to ECU 10 billion. Predictably, the smaller states resisted such an effort. In fact, Denmark, Ireland and the Benelux countries favored a *lower* threshold of ECU 750 million, so as to catch as many mergers as possible (*Financial Times*, 31 July 1989:2).

The second problem lay with the criteria used to evaluate covered mergers. In the proposal, the Commission provided a public interest provision suggesting that departures from pure competition criteria were possible. These were included at the behest of states such as France, Portugal, Spain and Italy who wanted merger authorities to consider industrial, regional and social policy concerns. According to the provision, mergers that created or strengthened a position of dominance, and which significantly reduced competition would nonetheless be allowed *if* these handicaps were outweighed by the contribution the merger made to attaining other objectives such as “promoting technical or economic progress” or “improving the competitive structure within the common market” (Article 2(4)).⁴⁷ While the language was well-received by France and Italy, for others, the very notion of diluting competition rules with industrial or regional policy criteria was anathema. Germany and Britain, in particular, opposed the inclusion of such a vaguely worded provision for fear that such a provision might lead the Commission to use it as a tool to pursue an activist industrial policy (Woolcock et al 1991:17).

Administrative responsibility and control was the final issue on which there was disagreement. While the Germans and the French desired centralized control in the Commission (for different reasons), the British continued to adamantly resist such an abdication of domestic authority. The Germans felt it was imperative to establish a single administrative entity beyond the political control of national governments. Deeply distrustful of what it perceived as Brussels’ industrial policy bent, the British government lobbied hard for decentralized control where national competition authorities would remain dominant. The smaller member states, for their part, supported centralized control. High economic interdependence coupled with the absence (in most cases) of effective domestic merger control regimes inclined smaller countries to favor more, not

⁴⁶ Governments were also concerned that if thresholds were not high enough to exempt all but the most potentially distorting mergers, the process of industrial adjustment associated with the completion of the internal market might be hampered.

⁴⁷ There was a striking similarity between the criteria included in the proposed “public interest” exemption and the criteria for exemptions found in the provisions of Article 85.

less, Commission control (Bulmer 1994:435, Schwartz 1993:651).

*iv. 1988-89: An Agreement At Last*⁴⁸

By late 1988, negotiations neared a standstill. It was beginning to look as though governments might not be able to produce a text acceptable to all. The Commission, in an effort to keep negotiations on track, offered two revised versions of the draft regulation; the first in November of 1988, and the second in March 1989. Notable among Commission changes were adjustments to the thresholds. Responding to a commitment by the British and Germans to end their objections to some of the less palatable provisions of the regulation if the thresholds were raised, the Commission raised the threshold of the acquired firm from a world turnover of ECU 50 million to ECU 100 million. More importantly for the British and Germans, the Commission also raised the worldwide turnover threshold for the merged firm from ECU 1 billion to ECU 5 billion. Although it was not the ECU 10 billion these countries had demanded, it was a major concession. Finally, the Commission stipulated that merger entities that generated two-thirds of the EC-turnover (down from three-quarters) in a single member state would also be exempt from review (*Financial Times*, 1 April 1989:1).

Despite the changes, and perhaps, in part, because of them, member states still found themselves at loggerheads in mid-1989. Although the Germans and British seemed satisfied with the higher thresholds, the smaller countries were not. They issue their own call for revised thresholds. They demanded that the worldwide threshold to be lowered to ECU 2 billion. Also, the French and Italians, dissatisfied with the ambiguous language of the public interest clause, continued to insist that industrial policy criteria be considered expressly as a factor in merger decisions. In June 1989, the required unanimity still seemed beyond reach.⁴⁹

The breakthrough credited with facilitating agreement was to come late in 1989. In July of that year, France assumed the Council Presidency. Articulated among its objectives was a desire to bring merger negotiations to a successful conclusion. Edith Cresson, France's European Affairs Minister, announced that Paris wanted a merger regulation by Christmas (*Financial Times*, 18 July 1989:2). As a gesture of good will to Britain and Germany, two countries still deeply suspicious of French motives, French negotiators softened their insistence that the regulation have a strong industrial policy identity (Schwartz 1993:652). Spurred in part by French leadership, the member states finally reached accord on 21 December 1989.

The final agreement had all the hallmarks of a classic political compromise (Bulmer 1994:435, Pathak 1990). On the matter of the regulation's scope, the final agreement on threshold represented a compromise on the part of all member governments. Advocates

⁴⁸ This section relies heavily on the excellent account of events provided in Schwartz (1993).

⁴⁹ The 1988 draft, like those that preceded it, was offered under Article 87 and 235. Consequently, unanimity would be required in the Council for the legislation to pass. The Commission continued to rely on these treaty bases despite Commissioner Sutherland's threat to look for an alternate legal foundation on which to offer a merger regulation.

of high thresholds, notably Germany and Britain, agreed to accept a standard lower than demanded. The Merger Regulation contained thresholds of ECU 250 million for Community turnover and an aggregate worldwide turnover of ECU 5 billion.⁵⁰ However, the Commission, with the support of the smaller states, won the concession that these thresholds were subject to review in five years time and that adjustments thereto would require only a qualified majority vote in the Council. Governments also reached a compromise on the standard against which mergers would be evaluated. The French, true to their commitment, softened their call for an industrial policy clause in the competition criteria (*Financial Times*, 12 October 1989:2). While the Regulation retained a version of the public interest clause, the criterion was closer to the formula originally offered by the Commission in its 1973 proposal and was in line with the preferences of the more neoliberal-minded member states.

Finally, the administrative framework embedded in the regulation also reflected elements of political compromise. To mollify concerns that authority granted to the Commission was too extensive, the so-called German clause was included in the final draft (Article 9). This provision holds that member governments can petition the Commission for the authority to conduct its own investigation where a prospective merger can be shown to have a substantial anti-competitive effect on a market *within* a member state. Interestingly, the Regulation also included a provision that can be regarded as essentially the mirror image of the “German Clause.” Known as the “Dutch Clause,” it empowers member states to invite the Commission to investigate mergers that fall below agreed upon thresholds, but which nonetheless might seriously affect the competitive situation within that member state. It was intended as a side payment to countries who worried that thresholds were too high. It was also intended to aid smaller members (such as the Netherlands) who felt they lacked either effective national laws or resources sufficient to deal with a merger that would have a significant effect on the domestic economy.

III. ANALYSIS OF THE MERGER REGULATION: PRINCIPALS, AGENTS AND CONTROL

For its first thirty years, the Community lacked a formal merger control regime. Among the barriers standing in the way of legislation was a running disagreement among member governments over how much administrative control should be exercised by the Commission. In this section, I explore this matter in more depth. First, I seek to provide a theoretically-based explanation for why governments elected to delegate administrative and enforcement authority to Commission. I then address the specifics of delegation itself, as manifested in the text of the Regulation.

A. Why Delegate?

⁵⁰ These are compared to the Community and worldwide turnovers of ECU100 million and ECU1 billion (respectively) stipulated in the 1988 draft. The final legislation also included a provision exempting mergers where >2/3 of EC turnover is in one state (compared to >75% in the 1988 proposal).

The principal benefit of delegation lay in the reduction of transaction costs.⁵¹ These costs were of two types. The first were the transaction costs born by firms when faced with multiple jurisdictional control. Firms incur costs where economic transactions are delayed or altered from the economically optimal by virtue of the need to conform to the rules governing competition in multiple member states. In the early years of the Community, when there were only six members and cross-border merger activity was limited, the costs attendant to multiple jurisdictional control was low. However, in the years that followed, the costs increased. Between 1957 and 1986, the European Community enlarged, first to nine, then to ten, and finally, with the accession of Spain and Portugal, to twelve. The very real prospect of future enlargements promised only to worsen the jurisdictional quandary.

Community governments faced an increasingly untenable situation. The rate of cross-border merger activity accelerated in the wake of the SEA. As the pace of economic integration quickened, the number and scale of “European” mergers rose markedly. Making things worse for firms and governments, Commission activism was also on the increase. Not only were more mergers subject to more national rules, but there was a chance, often of an unknown magnitude, that the Commission would weigh in on a transaction if it in any way raised concerns under Article 85 and 86.

But, what were governments to do? They had essentially three choices available to them. First, they could do nothing. This was the approach (such as it was) pursued throughout much of the 1960s and 1970s. Maintenance of the status quo during this period was not particularly problematic. Although merger activity was on the increase, merger control was not viewed by firms or governments as a particularly salient issue. However, by the mid-1980s, maintenance of the status quo was seen less and less as a viable option. Once member governments committed themselves to the single market project, they implicitly acknowledged the need to directly confront the merger issue. The internal market would never fully materialize so long as regulatory differences created incentives that undermined the market mechanism. In fact, one of the unsavory consequences of doing nothing was that firms or governments could (and probably would) exploit differences in national rules to manipulate market outcomes.

Faced with the need to do something, two alternatives offered a way to resolve regulatory disparities. First, governments could harmonize national merger rules. Alternately, Community actors could seek to centralize merger control. Each option had its own set of transaction costs. The costs involved were not the same as those associated with market exchange. Transaction costs, in this second sense, refers to the search costs and implementation costs associated with writing enforceable intergovernmental agreements.

Harmonizing national legislation promised to be extremely costly, both in terms of search costs and implementation costs. Some speculated whether it could be achieved at all (Hoelzler 1990). Given widely different national rule frameworks, there was a very high likelihood that governments would have difficulty deciding on a standard around which

⁵¹ I provide a fully articulated version of this argument elsewhere (Doleys 1999a). In the interest of space I will provide only a brief synopsis of the main points contained therein.

to harmonize. The search costs associated with finding a single standard might prove prohibitive. Moreover, even if governments should surmount these obstacles, there would still be the matter of implementation. In a decentralized system, governments would have to face the risk that, common rules notwithstanding, others might seek to covertly manipulate the system to serve domestic interests. The resources necessary to monitor the administration and enforcement of merger rules in eleven other states would be considerable.

The other alternative, centralization and delegation, seemed to hold more promise. It would not only be less costly than harmonization, but more effective. To be sure, there would be costs. Centralizing merger rules would require formal Community legislation. Consequently, there would be the search costs involved in reaching accord on a single body of rules. Nevertheless, the costs involved in writing and passing a single piece of Community legislation would likely be far lower than those associated with agreeing upon a single rule framework that would then have to surmount the additional hurdle of being transposed into domestic law.

When one reviews the history of merger legislation, one finds that, the principal disagreement among member governments was not centralization vs. decentralization per se, but what form centralization would take. Indeed, beginning with the 1972 Paris communiqué, member governments exhibited a remarkable degree of agreement that centralization was the preferred approach. Members wanted merger control to have a Community dimension, they just differed over the nature and degree of delegation necessary to insure its success.

Agreed that merger control should involve rule framework, member states had to resolve the question of administration. Again, governments had options? They could reserve administrative and enforcement authority for national competition authorities. In this way, rule-making would be centralized, while rule implementation would remain the province of domestic agencies. Though clearly a feasible option, it did however raise a formidable question, "who monitors the monitors?" Domestic competition authorities might face powerful pressures from domestic rent-seekers to "defect." Governments hurt by lax enforcement might feel domestic pressures to act in kind. Such a situation risked cascading into to systemic noncompliance.

The other option is to delegate administrative authority over centralized rules to a third party agent. Agency theory suggests that delegation would reduce considerably the monitoring costs involved in rule enforcement (Williamson 1985, Pratt and Zeckhauser 1985, Moe 1990).⁵² Monitoring costs would fall because the credibility of commitments would be enhanced. Delegation provides member states policy credibility by reducing the vulnerability of agreements to domestic political manipulation. The Commission, as a supranational institution, was vulnerable to political manipulation in the same way, or to the same extent, as domestic competition authorities. Moreover, third party agents like the Commission have much more to gain by enforcing rules assiduously: weak enforcement would destroy its credibility and undermine its legitimacy. For these

⁵² For an early effort to apply the insights of agency theory to the European Union, see Pollack (1997).

reasons, agency theorists conclude that the Commission would be much more likely to enforce rules than member governments (Gatsios and Seabright 1989).

Delegation to third party agents is not without costs. Chief among them is the risk that agents will use their delegated authority to pursue goals other than those it was assigned. This is the so-called “principals’ problem” (Ross 1973). The source of this problem is rooted in information asymmetries between principals and agents. Agents, it should be remembered, are independent actors. The fact that they bear some set of delegated rights does not change the fact that they have their own preferences and goals. In the course of the agency relationship, circumstances may arise when an agent will find it beneficial to exploit its privileged information to act opportunistically—a condition known in the parlance of agency theory as *shirking*.

Principals, however, can reduce the costs associated with shirking. They often do this through institutional design.⁵³ Principals structure the agency relationship *ex ante* in order to reduce information asymmetries and thereby reduce the threat that agents will shirk *ex post*. One way to do this is to limit the *scope* of agent behavior. This allows principals to circumscribe an agent’s operational purview. Principals can also reduce the risk of shirking by outlining specific *procedures* they must follow, or placing restrictions on the *instruments* at their disposal. Each allows principals to retain a measure of control while still allowing the agent the freedom to perform the role it was assigned.

B. Delegation and the 1989 Merger Regulation

Structurally, the relationship between member states and the Commission usefully regarded as one of principals and agent. Member governments are principals. They hold what might be called sovereign property rights. That is, they are the only actors in the system with the authority to control the disposition of legal entities under their jurisdiction. In the field of merger control, this means that, absent an agreement that stipulates otherwise, national governments are the only actors with the power to investigate, evaluate and judge the legality of mergers occurring within their borders.

The Commission, for its part, is an agent of member governments. It is an agent in two respects. First, whatever *formal* authority the Commission enjoys is expressly delegated to it by member governments. The Commission has no intrinsic authority, for it has no native sovereign property rights. All that it has must come from governments. The second and related respect in which the Commission is an agent is connected to the fact that it was created to serve a function. Delegated authority is not given unconditionally and without a purpose. Agents, as recipients of some bundle of rights, are expected to act on behalf of their benefactor(s).

Features indicative of an agency-type relationship are replete in the Merger Regulation. The Regulation stipulates several types of authority that are delegated by member governments to the Commission. The Regulation grants the Commission *sole*

⁵³ See, for example, McCubbins (1985), McCubbins and Page (1987), McCubbins, Noll and Weingast (1987, 1989).

jurisdiction to administer merger rules contained therein (Article 21). Commission officials would have the authority to initiate proceedings against firms suspected of violating provisions of the Regulation. To investigate suspect transactions, the Regulation granted the Commission extensive and invasive powers (Article 13). After evaluating suspected concentrations, the Commission also had the sole power of decision (Article 8). The Commission could demand changes in a prospective merger, or, when necessary, ban a merger outright. Finally, the Regulation conferred upon the Commission the authority to levy stiff penalties where individuals or firms.

The Commission's autonomy, however, was far from total. Although member governments recognized that independence and discretion were necessary to ensure regulatory effectiveness, they were unwilling to abdicate complete control. Governments included articles and clauses into the Regulation that placed clear limits on Commission independence. The most outward expression of this were the limits placed on the *scope* of the Regulation. Member governments sought to limit the applicability of the Regulation to only those mergers having a "Community dimension." This was accomplished through thresholds. Mergers were deemed to have a Community dimension and thereby subject to Commission scrutiny where: 1) aggregate worldwide turnover exceed ECU 5 billion, and 2) aggregate Community-wide turnover of each of at least two of the firms involved exceeded ECU 250 million. A merger that surpasses both thresholds might nevertheless be outside the Regulation's scope if each of the firms in question achieve greater than two-thirds of its Community turnover in a single member state.

Another measure member governments included to circumscribe the free exercise of Commission authority is the "public interest" exemption found in Article 21. This article reserves for member governments the right to "take appropriate measures to protect legitimate interests." Explicitly included among "legitimate interests" are the protection of "public security, plurality of the media and prudential rules." The article, however, makes no effort to define what is meant by "public security" or "prudential rules". In theory at least, member states could circumvent Community rules and Commission control for this rather large and underspecified class of transactions.

Member governments also imposed limits on the Commission's ability to alter the substance of the Regulation. While the Commission was free to take those measures necessary to ensure the implementation of the Regulation, any emendations or alterations to the provisions of the Regulation itself required explicit member state approval. Indicative of this control was the provision, outlined in Article 1(3), that required any changes to thresholds were subject to Council approval by a qualified majority vote.⁵⁴

Finally, in an effort to minimize information asymmetries, member governments also included an Advisory Committee in the Regulation. Article 19 provides this monitoring

⁵⁴ While qualified majority voting may be regarded as a less onerous standard than unanimity, it still represents a considerable barrier to agency slack, especially when principals are even nominally united in preventing an expansion in agent discretion. Indeed, in 1993, when the Commission sought to lower the worldwide threshold from ECU 5 billion to ECU 2 billion, the necessary majority was not forthcoming.

mechanism. It holds that the Commission was obliged to keep relevant authorities in the member states informed of its activities. It also subjects all Commission decisions to review. In this way, governments had a means to stay informed of the Commission's activities.

IV. CONCLUSION

In the introduction, I asked the question, "Why is there a Merger Regulation?" In the subsequent sections I argued that a full answer requires that we examine the Regulation, not as a singular event, but as the outcome of a process. At the center of the process is the European Commission. I proceed to highlight what I see to be the dual-track strategy pursued by the Commission to give merger control a Community dimension (and, thereby, secure for itself additional authority). One track of this strategy involved an expansive reading of the competition provisions of the Treaty of Rome. The second involved efforts to forward the cause through formal legislation. The Commission's privileged position in the legislative milieu conferred upon it important agenda setting powers. In recounting the evolution of merger control, the thing one finds striking is not the repeated failure of its legislative efforts, but the striking success of the Commission's other strategy. As demonstrated in the GEMA, Continental Can and Philip Morris decisions, the Commission creatively employed its extant competition authority under Article 85 and 86 in ways that progressively widened its *de facto* competency. Indeed, it was the threat posed by an anticipated wave of Commission activism in the wake of Philip Morris that helped bring negotiations to a successful conclusion.

The second question I addressed in this paper was "Why delegate?" The intent was to delve deeper into the administrative framework of the Merger Regulation in an effort to understand why it was organized the way it was. Specifically, I sought to offer an explanation for why otherwise independent sovereign governments saw fit to delegate a measure of their sovereignty to a supranational agent. Using concepts borrowed from principal-agent theory, I argue that governments delegate authority because it offers them manifest benefits. Where agreements among principals (in this case, member governments) are subject to the risk of ex post defection, delegation of monitoring and enforcement responsibilities to third party agents increases the credibility and stability of negotiated outcomes. With regard to the Merger Regulation, delegating authority to the Commission conferred credibility to a body of common rules that, while regarded as necessary by member governments, nonetheless were subject to the threat of cheating. The Commission, as a supranational actor, would not be subject to the political manipulations the might otherwise undermine the stability of a tenuous intergovernmental agreement.

This section also made clear that delegation has potential costs for principals. Some member governments were clear that the Commission should not be granted too extensive a mandate lest the Commission pursue goals other than those assigned to it. This is the essence of what is termed the "principals' problem." To minimize the risk that the Commission would act beyond its mandate, the Regulation included what governments regarded as prudential controls. These included clear limits on both the Commission's jurisdictional scope and the degree of discretion it enjoyed.

The analyses contained herein are only preliminary. A more detailed examination of member government and Commission preferences is clearly required. Nevertheless, the arguments put forward in this paper are suggestive. First, the paper suggests that legislative decisions are not a singular affair, but are typically part of a larger political process. Studies that posit a narrow view of decision-making rooted in intergovernmental negotiations are therefore neglecting an important side of the story. Second, the study suggests a useful framework with which to analyze the relationship between member governments and supranational institutions. Principal-agent theory offers a promising means to understand why governments find it useful to abdicate a measure of their sovereignty in some issue domains. The challenge for the future is to provide a theoretically robust way of identifying *ex ante* in which domains delegation is likely to be found and why.

**APPENDIX:
TREATY OF ROME COMPETITION ARTICLES**

ARTICLE 85

The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:

- (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
- (b) limit or control production, markets, technical development, or investment;
- (c) share markets or sources of supply;
- (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreement or decisions prohibited pursuant to this Article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings;
- any decision or category of decisions by associations of undertakings;
- any concerted practice or category of concerted practices;

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

- (a) impose on the undertaking concerned restrictions which are not indispensable to the attainment of these objectives;
- (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

ARTICLE 86

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as in compatible with the common market in so far as it may affect trade between Member States.

Such abuse may, in particular, consist in:

- (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
- (b) limiting production, markets or technical development to the prejudice of consumers;
- (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
- (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

ARTICLE 87

1. Within three years of the entry into force of this Treaty the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, adopt or appropriate regulations or directives to give effect to the principles set out in Articles 85 and 86.

If such provisions have not been adopted within the period mentioned, they shall be laid down by the Council, acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament.

2. The regulations or directives referred to in paragraph 1 shall be designed in particular:

- (a) to ensure compliance with the prohibitions laid down in Article 85(1) and in Article 86 by making provision for fines and periodic penalty payments;
- (b) to lay down detailed rules for the application of Article 85(3), taking into account the need to ensure effective supervision on the one hand, and to simplify administration to the greatest possible extent on the other;
- (c) to define, if need be, in the various branches of the economy, the scope of the provisions of Articles 85 and 86;
- (d) to define the respective functions of the Commission and of the Court of Justice in applying the provisions laid down in this paragraph;
- (e) to determine the relationship between national laws and the provisions contained in this Section or adopted pursuant to this Article.

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