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EC Competition Law and the Regulation of Passive Investments Among Competitors

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Abstract—Passive holdings and cross-investments among competing companies are common phenomena in the modern marketplace. Yet under certain market conditions such investments may cause anticompetitive effects. This article explores the economic effects of passive investments and their regulation under European competition law. The article identifies a range of transactions that potentially affect competition; however they remain unchallenged under current regulation. Subsequently, the article explores the possibility of applying the European Merger Regulation to these transactions.

1. *Introduction*

Passive investments[1] and cross-linkages among competing companies are common in the modern marketplace. A glance at the holding structure of companies around the world reveals many of these commercial ties.[2] Noticeable are cross investments in industries such as banking, energy, automobiles, air travel and car rental.[3] These

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[1] By 'passive' investments we refer to the case in which the investing firm shares the profits of the firm in which the investment has been made but exerts no influence over its activities.

[2] See for example the acquisition by Microsoft in August 1997 of approximately 7% of the non-voting stock of Apple, and in June 1999 its acquisition of a 10% stake in Inprise/Borland Corp. which is one of its main competitors in the software applications market (see 'Microsoft Investments Draw Federal Scrutiny', *Pittsburgh Post-Gazette*, 10 August, 1997, B-11, and 'Corel Again Buys a 'Victim' of Microsoft Juggernaut', *The Ottawa Citizen*, 8 February, 2000, C1.) Another example involves the US car rental industry; In the first half of the 1990's National Car Rental's controller, GM, passively held a 25% stake in Avis, while Hertz's controller, Ford, had acquired 100% of the preferred non-voting stock of Budget Rent a Car (see D. Purohit and R. Staelin, 'Rentals, Sales and Buybacks: Managing Secondary Distribution Channels' (1994) *Journal of Marketing Research*, 31, 325–39, and K. Talley, 'Avis Advertisements Fuel Questions' (1990) *Bus News*, 49, 1–2; also, between July 1999 and 2002, Credit Agricole (the second-largest French bank by capitalization and the strongest retail bank in France, with a 22% market share) held a 10.5% minority stake in its rival, Credit Lyonnais (the sixth-largest bank by capitalization). This is while Bank Societe Generale, with an 8% market share of the French retail market, also held a 4.8% stake in Lyonnais. See V. Mallet, 'Deal With Lyonnais Still on Agenda, Says Agricole', *Financial Times*, 29 November, 2002, p 26; S. Iskander, 'France Deal Marks A Watershed', *Financial Times*, 3 April 3, 2000, p 24. Agricole finally gained control of Credit Lyonnais in 2003. See M. Arnold, 'BNP Joins Agricole in Reshuffling Top Jobs Banking', *Financial Times*, 12 June, 2003, p 27.

[3] See ibid. Examples of industries that feature complex webs of cross shareholdings include the Japanese and the US automobile industries (W.A. Alley, 'Partial Ownership Arrangements and Collusion in the Automobile Industry' (1997) *Journal of Industrial Economics* 45, 191–205), the global airline industry ('Airlines with Ownership by Other Carriers' June 1998, *Airline Business News*, p 48.), the EU airline industry: see, e.g. Fraser Nelson, 'Gibraltar Row Clouds BA's Iberia Deal', *The Times*, 13 February, 1999 (discussing British Airways' 9% stake in Iberia);

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passive investments can stem from companies' desire to invest in a familiar industry, to spread risk or result from developing ties between companies as part of strategic alliances. When such activities involve companies operating in the same market, investments, even passive ones, may result in anticompetitive effects.

Under EC Competition law three regulatory instruments can potentially be used to monitor transactions involving passive investments. These are the European Merger Regulation,[4] Article 81 EC[5] and at times Article 82 EC.[6]

EC competition law provides a clear and well-based regulatory regime in cases of minority share acquisitions leading to *de-facto* control or facilitating collusion. On the other hand, cases that fall short of control or collusion may not be covered comprehensively as the existing regulatory instruments do not address all of the anticompetitive effects of passive investments.

This article explores the scope of each of the three regulatory instruments and uncovers their ability, and at times inability, to monitor passive investments. We start by illustrating passive investments' potential effect on competition. Following this, the article reviews EC competition law application to these categories of transactions and reveals the void in the current regulatory treatment of passive investments. The article then considers widening the application of the European Merger Regulation to cover passive investments that currently remain unchallenged under existing regulation.

2. *The Anticompetitive Effects*

Passive investment among competitors may cause anticompetitive effects when the relevant market is concentrated, the parties involved are strategic players in this market (rather than fringe firms) and the magnitude of passive investment is large enough. In these cases, passive investment may enable firms unilaterally to

'Lufthansa Purchases Airline Stake', *The Toronto Star*, 9 November, 1999 (regarding SAS's 20% stake in British Midland); Kevin Done, 'Lufthansa Raises Holding in BMI', *Financial Times*, 4 November, 2002 (regarding Lufthansa's 30% stake in British Midland); David Morrow, 'Swedish regulator clears tweaked SAS/Skyways tie-up', *Air Transport Intelligence*, 8 January, 2002 (discussing SAS's 25% stake in Skyways, a Swedish regional airline); 'Partner or Rival of Luxair?', *Luxemburger Wort*, 24 September, 1999, p 17 (discussing Lufthansa's 13% stake in Luxair, Luxembourg's national airline); Ralph Atkins, 'Cook and Caterer Weigh on Lufthansa', *Financial Times*, 26 March, 2004 (discussing Lufthansa's 25% stake in Eurowings, Germany's second largest airline); Sally Gethin, 'Ukraine International Taking More 737s', *Air Transport Intelligence*, 23 November, 1998 (discussing Austrian Airlines and Swissair's joint 25% stake in Ukraine International Airlines); Victoria Moores, 'Italy's Eurofly to Launch Transatlantic Premium Links', *Air Transport Intelligence*, 8 April, 2004 (discussing Alitalia's 20% minority stake in Eurofly)., the Dutch Financial Sector (E. Dietzenbacher, B. Smid, and B. Volkerink 'Horizontal Integration in the Dutch Financial Sector' (2000) *International Journal of Industrial Organization*, 18, 1223–42, and the Nordic power market (E. Amundsen and L. Bergman 'Will Cross-Ownership Re-Establish Market Power in the Nordic Power Market' (2002) *The Energy Journal* 23, 73–95) and the global steel industry (see D. Gilo, Y. Moshe and Y. Spiegel, 'Partial Cross Ownership and Tacit Collusion', 37, *RAND Journal of Economics* (2006) 81–99.

[4] Council Regulation (EC) No 139/2004 of 20 January, 2004 on the Control of Concentrations Between Undertakings (the EC Merger Regulation) OJ(2004) L 24/1.

[5] Article 81, Treaty Establishing the European Community.

[6] Article 82, Treaty Establishing the European Community.

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raise prices even absent collusion (explicit or tacit) (hereafter 'unilateral effects'). Additionally, passive investment may facilitate tacit or explicit collusion between competing undertakings (hereafter 'coordinated effects'). In what follows, we shall discuss the unilateral and coordinated effects separately.

A. *Imperfect Competition*

To understand the potential anticompetitive effects of passive investment, it is useful to identify why many markets have imperfect competition in the first instance. This will then shed light on how passive investments in such markets make competition even less perfect, thereby enabling firms unilaterally to raise prices.

In many markets there are only a small number of significant firms. In such markets, often referred to as oligopolistic markets,[7] price is usually above the marginal cost of supplying the product or service. This outcome stems primarily from the fact that many markets have some differentiation between firms' products.[8] That is, the products or services produced by the firms in question are somewhat different in the eyes of consumers. Classic examples are those of yogurt, morning newspapers, breakfast cereals, soft drinks, razor blades, cigarettes etc. Some consumers prefer one firm's brand, even if this brand is somewhat more expensive than the competing brand. If the price difference is large enough, however, the consumer would overcome his preference for the expensive brand and switch to the less expensive brand. In oligopolistic markets with product differentiation it can be shown that prices, even absent any kind of collusion between the firms, will be above marginal costs.[9]

The same is true for markets in which, although brands are very similar in consumers' eyes, the geographic location of the supplier is important, such as retail markets (gasoline, groceries, chain-stores, etc.). A consumer located closer to supplier A's outlet than to supplier B's outlet would prefer to buy from supplier A even when supplier B's price is somewhat lower. With geographic differentiation suppliers will be able to charge prices somewhat above their marginal costs as well.[10]

Finally, even in markets lacking any kind of differentiation, neither with regard to the product nor with regard to location, the price may be above marginal cost if firms' capacities are constrained.[11] In such cases, a firm would

[7] This, of course, implies that barriers to entry exist. If entry by many significant new firms is profitable, such firms are expected to enter the market and then the market would no longer be oligopolistic.

[8] See, e.g. J. Tirole *The Theory of Industrial Organization* (MIT Press, 1988) ch 7.

[9] Ibid.

[10] Ibid. Of course, when differentiation between two firms, either with respect to location or with respect to the product itself, is large enough, according to competition law these firms might be deemed not to compete with each other at all and therefore to belong to different markets. The degree of differentiation that would justify such a conclusion is a matter for public policy.

[11] See Tirole, above n 8 at 211.

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refrain from cutting price, as it would not be able to supply the exceeded demand that would follow a price cut.[12]

Hence, differentiated products and locations or constrained capacities may result in prices being above marginal cost. In what follows we examine how passive investment may cause prices to rise even further, even absent collusion.

B. *The Unilateral Effects of Passive Investment*

As seen above, in many oligopolistic markets price may exceed marginal costs. Interestingly, passive investment among firms in such markets may cause prices to rise even further beyond marginal cost.[13]

Imagine an oligopolistic market with differentiation, such as the cigarette market. Suppose firm A passively invests in firm B. This passive investment could cause prices to go up relative to the case without passive investment.[14] Absent passive investment, firm A would hesitate to raise the price of its brand, out of fear that such an increased price (although it would increase firm A's revenue per unit) would cause firm A to lose too many customers to firm B. However, if firm A passively invests in firm B, a price raise may become profitable. Although some of the customers may switch to firm B, firm A shares some of firm B's profits. Hence, the competitive constraints that prevented firm A from raising the price of its product diminish when firm A, through passive investment, absorbs part of firm B's profits.

The anticompetitive effect of passive investment may not end at this. In the case of differentiated goods, firm A's eagerness to raise prices will usually induce firm B and other rivals in the same market to raise prices as well.[15] When firm A

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[12] This type of imperfect competition resembles a model called Cournot, in which firms are assumed to set quantities instead of prices. In many scenarios, assuming that firms set quantities rather than prices is quite unrealistic as firms' main strategic tool is price rather than quantity. Interestingly, however, if one assumes, more realistically, that firms first set their production capacity (e.g. the size of their plant, their distribution channels, etc.) and afterwards set prices, then, under reasonable assumptions, the outcome is similar to the classic Cournot model. For details, see D. Kerps and J. Sheinkman, 'Quantity Precommitment and Bertrand Competition Yield Cournot Outcomes' (1983) 14 *Bell Journal of Economics* 326–37.

[13] R.J. Reynolds and B.R. Snapp, 'The Competitive effects of Partial Equity Interests and Joint Ventures' (1986) *International Journal of Industrial Organization* at 4 141-153; T.F. Bresnahan and S.C. Salop, 'Quantifying the Competitive Effects of Production Joint Ventures' (1986) *International Journal of Industrial Organization*, 4, 155–75; D.P. O'Brien and S.C. Salop, 'Competitive Effects of Partial Ownership: Financial Interest and Corporate Control' (2000) *Antitrust Law Journal* 67, 559; F. Bolle and W. Güth, 'Competition Among Mutually Dependent Sellers' (1992) *Journal of Institutional and Theoretical Economics*, 148, 209–39; D. Flath, 'When is it Rational for Firms to Acquire Silent Interests in Rivals?' (1991) *International Journal of Industrial Organization*, 9, 573–83. For empirical evidence of the effect of passive investment among competitors on the price-cost margins see: Alley, above n 3.

[14] See Flath, ibid.

[15] Ibid. This is under the realistic assumption that firms strategically compete with each other with regard to the price they set. This result stands in contrast to the analysis of Robin A. Stuijlaart, 'Minority Share Acquisitions below the Control Threshold of the EC Merger Control Regulation: An Economic and Legal Analysis' (2002) 25 *World Competition* 173–204. Stuijlaart implies that in markets characterized by brand loyalty, such as cigarettes, in which firms set prices rather than quantities, the unilateral anticompetitive effects of passive investments are unlikely. However, as shown, the unilateral anticompetitive effects are intact in such markets. Actually, these anticompetitive effects are even more pronounced in price-setting differentiated product models than in the quantity setting models mentioned by Stuijlaart. This is because in a quantity setting model, it is actually unprofitable for a firm to passively invest in a rival in order to raise prices, as this improves the position of rivals at the expense of the investing firm. See Flath, above n 13, and D. Reitman, 'Partial Ownership Arrangements and the Potential for Collusion' (1994) 42 *Journal of Industrial Economics* 313.

raises its price, firm A's brand becomes less attractive to consumers. This enables firm A's rivals profitably to raise its prices relative to the prices they charged before firm A raised its price, without losing market share to firm A.[16] In other words, firm A's passive investment that enabled it to raise price, may subsequently lead to an increase in prices throughout the market.

The discussion above illustrates how the unilateral effects of passive investment may transform an imperfectly competitive market into an even less competitive market. Indeed, if the market is perfectly competitive (i.e., prices equal marginal costs), it has been shown that passive investments have no unilateral effects.[17] The only anticompetitive effect of passive investments would then be facilitation of collusion.[18]

C. *The Coordinated Effects of Passive Investment*

Passive investments in oligopolistic industries may also cause 'coordinated' anticompetitive effects, in that they may facilitate tacit or explicit collusion. While explicit collusion may be less likely, due to the fear of intervention by competition authorities, tacit collusion is an imminent threat in industries with only a few significant firms. 'Tacit collusion' refers to a situation where cartel-like prices are sustainable even without communication between the firms. Each firm may refrain from undercutting a collusive price out of the fear that this would trigger a long-term price war. Such a price war could involve long-term losses that may outweigh the short-term profits of the price-cutting firm.[19] Unlike explicit collusion, tacit collusion is very difficult for competition authorities to detect or prove.[20]

By its nature, collusion may be difficult to sustain. It is enough that for at least one firm the short-term profit during a price cut outweighs the long-term losses

[16] See ibid, and, generally, J. Bulow et al.,'Multimarket Oligopoly: Strategic Substitutes and Complements' (1985) 93 *Journal of Political Economy* 488 (showing that in models with differentiated products and price-setting firms, when one firm becomes more eager to raise prices, its rivals become more eager to raise prices as well). This result, again, is in contrast with Stuijlaart's implication (ibid) according to which passive investment has to be multilateral in order to have anticompetitive effects. As shown in the text, it is enough if one firm invests in a rival for unilateral anticompetitive effects to be present. Furthermore, as shown, it is often enough for one firm to invest in a rival in order to induce less competitive behaviour from itself *and* its rivals, even if these rivals have not invested in a rival. It should be noted that in the case where competition is imperfect because firms' capacities are constrained, passive investment among rivals has qualitatively similar unilateral anticompetitive effects. Here too even if a single firm invests in a rival, this firm would want to raise prices, and its rivals would react by raising prices themselves.

[17] Perfect competition could exist if there are many significant firms in the market, thereby lowering prices to be very close to marginal costs. It also could exist in oligopolistic markets—with only a few firms—if products are homogenous (there is no differentiation, as in the steel, milk, or electricity markets) and there are no capacity constraints.

[18] D. Gilo, 'Partial Ownership as a Strategic Variable to Facilitate Tacit Collusion' at 2.21, 3.1.1 (John M. Olin Discussion Paper No. 170, Program in Law, Economics, and Business, Harvard Law School) (1995) (unpublished, on file with author) (showing that in markets without differentiation and without capacity constraints passive investment has no unilateral effects).

[19] See Tirole, above n 8 at ch 6.

[20] Tacit collusion in an oligopolistic market requires undertakings to be able to reach tacit agreement, to detect breaches, and to punish deviations from the tacit agreement. In the *Airtours* case, the European Court of First Instance reviewed the conditions for collective dominance under EU law and brought them broadly in line with the above three conditions. See Case T-342/99, *Airtours plc* v *Commission* [2002] 5 CMLR 317, para 62.

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from a price war in order for tacit collusion to cease. Moreover, where other firms are aware of this firm's eagerness to price-cut, collusion may not be sustainable in the first instance, since even firms that prefer collusion to price-cutting would not want to charge a collusive price when such price may be immediately undercut by a rival.

This brings us to the reason passive investment may facilitate tacit collusion: when a firm invests in a rival in an oligopolistic industry, the investing firm may become less eager to price-cut on a collusive price. This is because it would absorb a portion of the rival's losses from this price-cut.[21] In addition, as shown by Gilo and Spiegel,[22] passive investment by an efficient firm in a relatively less efficient firm may cause the collusive price to be higher than absent passive investment.[23]

It is important to emphasize that passive investment among rivals in oligopolistic industries will not always facilitate collusion. Unilateral passive investment may facilitate collusion only where the investment in the rival was made by the firm most eager to price-cut. Such a firm is termed by competition authorities as 'the industry maverick'.[24] When non-maverick firms are the only ones in the industry that invest in rivals, their passive investment will have no effect on the stability of collusion, since they lack the incentive to price-cut that could topple collusion. Where the maverick finds it profitable to undercut the collusive price, collusion will break down regardless of other firms' passive investments in each other. On the other hand, where the maverick finds it unprofitable to undercut the collusive price, collusion will not break down, again, regardless of other firms' passive investments in each other.[25]

Accordingly, if a firm other than the industry maverick invests in a competitor, passive investment is likely to have no coordinated anticompetitive effects, but rather only unilateral anticompetitive effects, as discussed in section 2B above. On the other hand, if the industry maverick invests in a rival, coordinated anticompetitive effects may occur, in addition to other competitive concerns. According to the Commission's Guidelines on the assessment of horizontal mergers,[26] *merger with* a maverick firm raises particular competitive concerns.[27] The analysis here reveals that *passive investment by* an industry maverick also raises particular competitive concerns, due to the possible coordinated effects.

[21] Of course, the economic analysis of explicit collusion is similar. Accordingly, passive investment also facilitates explicit collusion.

[22] D. Gilo and Y. Spiegel, 'Partial Cross Ownership and Tacit Collusion' (Working paper, Tel Aviv University, 2003) (on file with author).

[23] The reason for this result is that a more efficient firm generally prefers a lower collusive price than a less efficient firm. Passive investment by the efficient firm in the less efficient firm makes the efficient firm partly identify with the less efficient firm's interests and thus they 'compromise' on a higher collusive price when colluding.

[24] See Guidelines on the Assessment of Horizontal Mergers Under the Council Regulation on the Control of Concentrations Between Undertakings [2004] OJ C31/03, s 20.

[25] See Gilo, Moshe and Spiegel, above n 3.

[26] Above n 24.

[27] Ibid at s 20.

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Another notable case in which passive investment among rivals may not facilitate collusion (but rather possess only unilateral effects) is where although passive investment somewhat deters the maverick from deviating, it at the same time softens the outcome of deviating. As noted, collusion may be sustainable when the maverick finds price-cutting unprofitable, due to its fear of the price war that would follow a price cut. A price war would return the pricing to that which would have evolved absent collusion. However, as illustrated in section 2B above, passive investment also affects the pricing that would evolve absent collusion. Since passive investment raises the prices and profits of firms absent collusion, it tends to soften price wars, and this could lower their deterrent effect. Malueg's economic model[28] shows that for some levels of passive investment, this effect of softened price wars outweighs passive investment's regular effect of making price-cutting less profitable. Accordingly, in such cases too, passive investment would cause only unilateral anticompetitive effects.[29]

D. *Passive Investment by Controlling Shareholders*

At times, passive investments may give rise to anticompetitive concerns even when they do not involve competing firms. Anticompetitive effects may occur when a firm (or person) controlling one company passively invests in that company's competitor.

When a firm's controlling shareholder invests in this firm's competitor, the potential unilateral and coordinated anticompetitive effects are similar to those involving passive investment among the rivals themselves. Since the controlling shareholder partly identifies with the profits and losses of the rival firm, the controller tends to make his own firm compete less vigorously.[30] Interestingly, the anticompetitive effects are stronger the lower the controller's stake in his own firm.[31] This is because the lower the controller's stake in his own firm, the more weight he places on his stake in the rival firm, and the less vigorously he tends to manage his own firm.

The potential anticompetitive effect of passive investment by controlling shareholders is at times ignored. This was the case in the *Nordbanken/Postgirot* transaction,[32] where the Commission approved the acquisition by Scandinavian banking group Nordea of the sole control of Sweden's Postgirot Bank AB. As part of clearing the transaction the Commission required Nordbanken to reduce

[28] D. Malueg, 'Collusive Behavior and Partial Ownership of Rivals' (1992) 10 *International Journal of Industrial Organization*, 27–34.

[29] As noted in the introduction, some industries, such as the Dutch financial sector, the Nordic power market, the global steel industry and the global and EU airline industries, feature multilateral minority investments among competitors. In such cases, the coordinated effects of passive investment are more complex. For example, a recent economic study implies that if a firm increases its stake in the maverick firm, then there are no coordinated effects. In such cases too, therefore, passive investment involves only unilateral effects. See Gilo, Moshe and Spiegel, above n 3.

[30] Ibid.

[31] Ibid.

[32] Case No COMP/M.2567, see also press release IP/01/1552.

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its stake in Bankgirot, another Swedish bank that Nordea previously controlled, to a passive 10 per cent stake.

The economic analysis implies that anticompetitive threats may potentially remain, given that the controller of Postgirot has a stake in Postgirot's rival, Bankgirot. As long as Nordbanken holds a large controlling stake in Postgirot, the mere 10 per cent stake that Nordbanken holds in Bankgirot may not involve substantial anticompetitive effects. However, future dilution of Nordbanken's stake in Postgirot may result in an anticompetitive effect since such dilution is as anticompetitive as an increase in Nordea's stake in Bankgirot. Accordingly, it may have been warranted to condition the transaction upon Nordea refraining from diluting its stake in Postgirot in the future. The more diluted Nordea's stake in Postgirot, the more weight Nordea would place on its passive stake in Bankgirot.

E. *Comment*

As illustrated above, passive investments among competitors in oligopolistic markets may result in both unilateral and coordinated effects. While coordinated effects fail at times to matriculate, unilateral effects remain intact. The strength of the unilateral and coordinated effects is directly linked to the level of holdings, the profits or losses channeled through the investment, their effect on the investor's 'own' profits, and the position of the investing company (competitor or controller) in the market. Naturally, the potential impact of passive investments is measured on a case by case basis and is at times difficult to establish. This undoubtedly affects the regulator's ability to monitor and remedy such occurrences.

In what follows, we look at the way in which the European regulatory regime confronted the anticompetitive effects of passive investments.

3. *The European Regulatory Regime*

The regulation of share acquisition under EC competition law is largely effected by the EC Merger Regulation (ECMR).[33] When a transaction is classified as a *Concentration* having a *Community Dimension*, it will be subject to the exclusive jurisdiction of the ECMR.[34] It is therefore useful to use the ECMR as a starting point to observe the control of passive investments under EC competition law.

A. *The European Merger Regulation*

As mentioned above, the ECMR applies to Concentrations having a Community Dimension.[35] Transactions falling short of a Community Dimension will

[33] Council Regulation (EC) No 139/2004 of January 2004 on the Control of Concentrations between Undertakings OJ [2004] L 24/1.

[34] Ibid, Art 22.

[35] Ibid, Art 1.

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generally fall outside the ECMR.[36] Community Dimension is established where a transaction reaches the thresholds set in Article 1 ECMR.[37] These thresholds, based on worldwide and Community-wide turnovers, provide a clear jurisdictional criterion. Subject to the possibility to refer cases between the Commission and Member States,[38] a concentration satisfying these thresholds would benefit from the 'one-stop-shop' and would be subject to the exclusive jurisdiction of the ECMR.[39]

For a share acquisition to come within the jurisdiction of the ECMR, it has to fall under the definition of a *Concentration*. The concept of concentration is defined in Article 3 ECMR and covers operations bringing about a lasting change in the control of the undertakings concerned.[40] Section 3 of Article 3 establishes sole or joint control as 'rights, contracts or any other means which, either separately or in combination ..., confer the possibility of exercising decisive influence on an undertaking'.[41] Control may be established through the acquisition of property rights, shareholders' agreements or economic relationships leading to control on a factual basis.[42]

The definition of control triggers an interesting debate in the context of the acquisition of minority shareholdings. In this respect, partial equity interests would only be subject to the ECMR when they result in the ability to exercise decisive influence and thus qualify as a concentration. The Commission's notice on the notion of a concentration clarifies when this could be possible.[43] The notice refers to the possibility of establishing control through qualified minority. This may occur where specific rights are attached to the minority shareholding, where a minority shareholder has the right to manage the activities of the company or where collective choice problems result in *de-facto* control (i.e. the other shareholders are so dispersed and small that even a minority stake enables its holder to exercise control).[44] In the case of joint control, decisive influence is typically established through deadlock situations where actions determining the strategic commercial behaviour of an undertaking may be blocked by a minority shareholder.[45] Consequently, a passive investment falling short of establishing joint or sole control would not fall within the realm of the ECMR.

In the *Arjomari/Wiggins* transaction,[46] the Commission reviewed the concept of *de-facto* control. Arjomari, with 39 per cent of the shares in Wiggins, was held

[36] Note Arts 9 and 22 ECMR which allow a referral from the Commission to the competent authorities of the Member States and vice versa.

[37] See also Commission Notice on Calculation of Turnover [1998] OJ C66/25

[38] Arts 4, 9, 22, Council Regulation 139/2004.

[39] Art 21, Council Regulation 139/2004.

[40] Art 3, Recital 20, Council Regulation 139/2004.

[41] Ibid.

[42] Commission Notice on the Notion of a Concentration [1994] OJ C385/5; P.M. Roth (ed.), *Bellamy & Child European Community Law of Competition* (Sweet and Maxwell, 5th edn, 2001) 6-029—6-060.

[43] Ibid.

[44] Ibid.

[45] Ibid, para 19.

[46] Case No IV/M.0025, *Arjomari-Prioux-SA/Wiggins Teape Appleton plc* [prior notification published in [1990] OJ C285].

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to have decisive influence since the remainder of Wiggins' shares was held by 107,000 other shareholders, none of whom owned more than 4 per cent. In *AAC/Lonrho*[47] control was established with an acquisition by AAC of 27 per cent in Lonrho.[48] Similar to the *Arjomari/Wiggins* transaction, the disparity of the other shareholders meant that AAC could gain *de-facto* control over Lonrho. The Commission reviewed evidence from polls held at Lonrho shareholders' meetings in previous years to ascertain whether AAC's level of holding would suffice to establish control, thus classifying the operation as a concentration.[49]

As hinted above, the level of shareholdings alone should not be interpreted as setting a definite criterion.[50] In principle, even absent special voting and veto rights, collective choice problems could result in decisive influence at even lower levels of shareholding than described above.[51]

In *Nordbanken/Postgirot*[52] the Commission reviewed the acquisition by Scandinavian banking group Nordea of the sole control of Sweden's Postgirot Bank AB. In order to resolve the competition concerns arising from the transaction, Nordbanken undertook to eliminate its control in a third undertaking. This supposedly remedied concerns regarding structural links and potential coordination in the market. The divestiture included, among others, a reduction of Nordbanken shareholdings in the third undertaking to no more than 10 per cent.[53] In its press release the Commission stated that 'Nordea undertook to reduce its stake in Bankgirot to 10 per cent, a level which will no longer give it decisive influence over the company'.[54] Although this was part of the commitments required by the Commission, and did not form part of the examination of whether there was a concentration, the Commission's statement is interesting. It implies that the Commission is willing to 'stretch' the notion of control and establish decisive influence even in a case with relatively low shareholdings.[55]

Cases involving joint control may potentially allow the application of the ECMR to even lower shareholdings.[56] Deadlock situations may allow a small

[47] Case No IV/M.754, *Anglo American Corporation/Lonrho* [1998] OJ L 149/21.

[48] Note that the Commission considered the question of control on the basis of a total holding of 27.47 %.

[49] In the earlier *Mediobanca/Generali* case, the Commission applied a similar analysis, concluding that a concentration does not exist. In this case the Commission assessed whether a holding of 12.84% could constitute *control* by analysing the participation of other shareholders in shareholders meetings. Following this, the Commission concluded that *sole control* could not be established with such holding. (reference was also made to the absence of joint control in this case). See Case No. IV/M.159, *Mediobanca/Generali* [1991] OJ C334/23.

[50] See for example: Case No IV/M.343, *Société Générale de Belgique/Générale de Banque* [prior notification published in [1993] OJ C158]; Case No IV/M.613, *Jefferson Smurfit Group PLC/Munksjo AB* [prior notification published in [1995] OJ C169]; Case No IV/M.731, *Kvaerner/Trafalgar* [prior notification published in [1996] OJ C83].

[51] On collective choice problems see, F.H. Easterbrook and D.R. Fischel, *The Economic Structure of Corporate Law* (Harvard University Press, 1991), ch 3.

[52] Case No COMP/M.2567, see also press release IP/01/1552.

[53] Bankgirot also agreed to refrain from any shareholder rights going beyond minority protection rights safeguarding the financial value of its stake.

[54] From the Commission press release. Note that in this case the Commission does not make a direct reference to 10% being the threshold for decisive influence. See also para 62 in the Commission decision, above n 52.

[55] See generally: E. Moavero Milanesi and A. Winterstein 'Minority Shareholding, Interlocking Directorships and the EC Competition Rules—Recent Commission Practice' (2002) *Competition Policy Newsletter* 15.

[56] C.J. Cook and C.S. Kerse, *E.C. Merger Control* (Sweet and Maxwell, 3rd edn, 2000), 29–47.

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shareholder to affect the strategic commercial behaviour of an undertaking. Establishing joint control is not only limited to explicit contractual veto rights. In exceptional cases the Commission can establish joint control on a *de-facto* basis where strong common interests exist between minority shareholders.[57] This can stretch the concept of joint control, thus widening the application of the ECMR.

In *Hutchison/RCPM/ECT*[58] the Commission established such *de-facto* joint control based on common interests between Hutchison and RMPM, which according to the Commission, would prevent the parties from voting against each other. The Commission referred to a commonality of understanding between the parties, the structure of the shareholdings and voting rules and the high degree of mutual dependency between the undertakings, as the main elements proving *de-facto* joint control. Following this the Commission concluded that the operation constituted a concentration falling within the scope of the ECMR.

Even with the thresholds for *control* under the ECMR being lower than first expected, still its application is limited to investments leading to control. Therefore the ECMR, as currently applied, fails to address effectively the anticompetitive effect of passive investments. This limit was addressed in the Green Paper published in 2001. As part of the consultation leading to the paper, the Commission explored the possibility of widening the scope of the ECMR to cover passive investments. The Commission acknowledged the possibility that 'minority shareholding (potentially coupled with interlocking directorships) may alter the linked companies' incentive to compete and may thus have an impact upon market conditions'.[59] Nevertheless, the Commission, backed by Member States, concluded that the regulation of passive minority shareholding under the new Merger Regulation should be outside the scope of the merger regime. Most member states agreed with the Commission's position, saying it would be disproportionate to extend the Merger Regulations' application to passive investments.[60] The Commission and Member States thus vowed to retain *control* as the criterion for assessment under the Merger Regulation, and favoured it over alternative tests based on shareholdings.[61]

[57] Para 32, Commission Notice on the Concept of Concentration [1998] OJ C66/5.

[58] Case No COMP/ JV.55, *Hutchison/RCPM/ECT* [prior notification published in [2001] OJ C39/04].

[59] Para 107, Green Paper on the Review of Council Regulation (EEC) No 4064/89.

[60] See, for example, United Kingdom response to the Commission Green Paper on the Review of Council regulation (EEC) NO 4064/89 Department of Trade and Industry, March 2002, para 40; also Reply of the *German* Federal Government to the Green Paper of the European Commission on the Review of Council Regulation (EEC) No 4064/89 (COM(2001) 745/6 final version) of 11 December, 2001.

[61] See for example the German merger assessment rules that base the definition of a merger transaction on a wider test comprised of *control* as well as the acquisition of 25% of the capital or the right to vote of another undertaking. Such a merger transaction will thus be subject to prior notification. Section 37(3) *Gesetz gegen Wettbewerbsbeschränkungen* 1998; also see references made by the Commission in para 108 of the Green Paper. Note, that in the US, s 7 of the Clayton Act extends its application to all forms of minority shareholdings. This section condemns acquisitions of 'the whole or any part of the stock' of another firm where 'the effect of such acquisition may be substantially to lessen competition'. The third paragraph of this section, however, as interpreted by US courts, includes a *de facto* exemption of passive investments. See D. Gilo, 'The Anticompetitive Effect of Passive Investment' (2000) 99 *Mich. L. Rev.* 1.

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Two main arguments in favour of retaining the definition of *control* were echoed as part of this consultation. First, the Commission and Member States considered Articles 81 and 82 EC to provide adequate tools for the regulation of passive investments. Secondly, the mandatory prior notification in the ECMR was considered inadequate for the regulation of passive investments. Applying an *ex-ante* notification mechanism to passive investments absent the attainment of control would have mounted an unnecessary burden on undertakings involved in transactions which, according to the Commission and Member States, are mostly benign.[62]

Accordingly, the ECMR and its prior notification mechanism are limited to those transactions establishing *control* and would not be applied to 'pure' passive investments.[63]

B. *Article 81 EC*

Article 81 EC partially fills the gap left by the ECMR and provides for the regulation of transactions falling short of *control*.

In the *Philip Morris* case,[64] which was heard before the ECMR came into force, the ECJ commented on the acquisition of an equity interest. In outline, the agreement provided for the acquisition by Philip Morris of 30 per cent of Rothmans, its rival in the cigarette market, while limiting voting rights to 24.9 per cent. Additionally, the agreement included first refusal rights and did not allow Philip Morris to gain managerial influence over Rothmans. The ECJ upheld the Commission's decision clearing the transaction, ruling that an 'acquisition by one company of an equity interest in a competitor does not in itself constitute conduct restricting competition'.[65]

The court observed the potential effect that could occur in oligopolistic markets through an acquisition of a substantial shareholding, albeit a minority one, in a competing company:

> although the acquisition by one company of an equity interest in a competitor does not in itself constitute conduct restricting competition, such an acquisition may nevertheless serve as an instrument for influencing the commercial conduct of the companies in

[62] Paras 107, 109, Green Paper on the Review of Council regulation (EEC) No 4064/89 COM /2001/0745 Final.

[63] See for example Case IV/M.159, *Mediobanca/Generali* [1991] OJ C334/23 and on appeal T-83/92, *Zunis Holding and Others* v *E.C. Commission* [1993] II E.C.R. 1169, [1994] 5 CMLR 154 and *Zunis Holding SA and Others* v *E.C. Commission* (Case C-480/93P) Before the Court of Justice of the European Communities (5th Chamber). In this case, an increase in shareholding from 5.98% to 12.84% was held not fall within the scope of the merger regulation. The Commission, taking into account an agreement between the major shareholders, held that the purchaser would not be in a position to exercise, by itself or together with others, a 'decisive influence' on the target company.

[64] Cases 142/84 and 156/84, *British American Tobacco Company Limited and R. J. Reynolds Industries Inc.* v *E.C. Commission (Philip Morris Inc. and Rembrandt Group Limited* intervening) before the Court of Justice of the European Communities (6th Chamber) [1987] ECR 4487; [1988] 4 CMLR 24.

[65] Ibid, para 37.

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question so as to restrict or distort competition on the market in which they carry on business.[66]

The court particularly focused on the possibility of distortion where the investing company obtains 'legal or *de facto* control of the commercial conduct of the other or where the agreement provides for commercial cooperation between the companies or creates a structure likely to be used for such cooperation'.

The court's rhetoric evolved around the concept of *control*, the potential for informal influence flowing from Philip Morris's capacity as a substantial shareholder, the potential for future reinforcement of the investor position and the economic context surrounding the acquisition. The court highlighted that what may look like a passive investment may result in a takeover of a competitor.[67]

Before the enactment of the ECMR, the Commission applied the *Philip Morris* standard to a growing number of minority acquisitions.[68] However, the coming into force of the ECMR in 1990 significantly impacted the role played by the *Philip Morris* case. As shown above, the ECMR applies to concentrations involving decisive influence.[69] As a result, the residual role played by *Philip Morris* has been diminished, as it relies primarily on concepts of *control*.[70]

In the *BT/MCI* case[71] the Commission cleared the acquisition by BT of a 20 per cent stake in the share capital of MCI, referring to the *Philip Morris* ruling. In this case the acquisition did not provide BT with the possibility to seek control over or influence MCI. Additionally, it did not give rise to coordination of the competitive behaviour of the two companies that operated in the global telecommunications market.[72] The Commission stated that the acquisition falls outside Article 81(1) as the article 'does not apply to agreements for the sale or purchase of shares as such'.[73] It added that, in principle, Article 81 EC could apply when in the specific contractual and market contexts the case leads to the coordination of the competitive behaviour of the parties.

Similarly, in *Olivety/Digital*[74] the Commission approved a cooperation agreement in the field of computer systems between the two companies that was accompanied by the acquisition by Digital of approximately eight per cent of Olivetti's share capital. The Commission concluded that the agreements would not lead to a change in the control of Olivetti or to coordination of business behaviour.

[66] Ibid, para 37.
[67] Ibid, para 45.
[68] For a description of these transactions see B.E. Hawk and H.L. Huser, 'Controling the Shifting Sands: Minority Shareholding under EEC Competition Law' (1994) *Fordham International Law Journal* 294, 300
[69] Art 22, Council Regulation 139/2004.
[70] For an overview of different interpretations of the case and its reliance on concepts of *control*, see Struijlaart, above n 15.
[71] Case IV/34.857, *BT/MCI* [1994] OJ L 223/36, para 44.
[72] Ibid, paras 13 and 15.
[73] Ibid, para 44.
[74] Case IV/34.410, *Olivetti/Digital* [1994] OJ L 309/24.

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The language of Article 81 EC and its interpretation by the European Courts and the Commission makes it difficult to apply it to cases that do not give rise to a clear coordinated effect. A narrow reading of the *Philip Morris* decision leads to the conclusion that Article 81 only applies to limited scenarios where acquisition of a minority share leads to coordination or attainment of control. Such a reading relies on the court's focus on anticompetitive effects stemming from de-facto control, co-operation, and the possibility of a long-term plan to collude or to takeover the target company. Accordingly, partial equity interests, in oligopolistic settings, which involve some influence of a significant firm in a rival[75] (albeit not amounting to decisive influence, thereby invoking the exclusive applicability of the ECMR), or enable the exchange of competitively sensitive information between competitors, would potentially be subject to Article 81. Similarly, a passive holding that facilitates coordination between the companies or may lead to a takeover in the future would be subject to Article 81. However, a narrow reading of Article 81 and the *Philip Morris* decision would leave cases leaning solely toward unilateral effects outside the realm of Article 81.[76]

It may be possible to adopt a wider interpretation of the *Philip Morris* decision, under which unilateral effects may also be challenged under Article 81. Indeed the court focused on the possibility that the transaction may result in a takeover or establish co-operation between the companies. Yet the court could have provided the Commission with a wider mandate. In its judgement the court refers to the possibility that the acquisition may 'serve as an instrument for influencing the commercial conduct of the companies'[77] and later to the Commission's task 'to show that the agreement has the object or effect of influencing the competitive behaviour of the companies on the relevant market'.[78]

The scope of the court's decision may encompass unilateral effects that result from the agreement between the parties (i.e. the share purchase agreement). According to this interpretation, Article 81 could apply when an agreement results in a unilateral anticompetitive effect, leading the companies unilaterally to raise prices.[79] Such an approach views the purchase as satisfying the 'agreement' condition in Article 81 EC, even when not part of a wider scheme of agreements. However, the *Philip Morris* decision did not address the possible unilateral effects of passive investment and the phrase referring to a share acquisition that may 'serve as an instrument for influencing the commercial

[75] See for example the *Parmalat/Consorzio Emiliano Romagnolo Produttori Latte* case [Italy] which was referred to in the Parliament Committee on Economic and Monetary Affairs Hearing on the Green Paper on the Review of Council Regulation 4064/89, April 15 2002.

[76] In *Philip Morris*, the court explored the different effects that may result from passive investments. Those included the possibility of establishing *de-facto* control, facilitating co-operation between the companies, and the possibility that the acquisition is part of a long-term plan to collude or to takeover the target company. The court's analysis did not refer to the possibility of passive investment resulting in unilateral anticompetitive effects and subsequently did not discuss the possibility of applying Article 81 to such unilateral effects. Above n 64, paras 38, 39.

[77] Above n 64, para 37.

[78] Above n 64, para 45.

[79] Note that the unilateral effect resulted from an agreement to purchase shares and is not a result of unilateral action.

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conduct of the companies' is quite vague. Therefore, this broad interpretation of *Philip Morris* may not do justice to the ECJ's intentions. Indeed, if the broad interpretation were correct, the ECJ's final ruling clearing the transaction in *Philip Morris* would have been questionable as one could argue that unilateral effects were present in the cigarette industry following the transaction. Furthermore, the Commission's approach in the BT/MCI case[80] seems to support the narrow interpretation of the *Philip Morris* decision. In its decision the Commission stated:

> As a general rule, both the Commission and the Court of Justice have taken the view in the past that Article 85 (1) does not apply to agreements for the sale or purchase of shares as such. However, it might do so, given the specific contractual and market contexts of each case, if the competitive behaviour of the parties is to be *coordinated* or *influenced*.[81]

The Commission mentioned the two elements of coordination and influence. Nevertheless in the analysis that followed the Commission referred to the first element of coordination and did not separately explore the notion of influence outside the question of control or partial control. Hence, 'influence' was read by the Commission as enabling control of the company in which the investment had been made (or at least some influence over its activities) and not as an independent element relating to the influence the acquisition might have on each of the companies' unilateral pricing behaviour. Subsequently, the Commission did not explore the possibility for unilateral effects and found the investment not to infringe Article 81.[82] The Commission's analysis seems to support the narrow approach discussed above, thus leaving unilateral effects outside the realm of Article 81.

Unfortunately, as the economic analysis of section 2 reveals, there are many cases in which passive investment among competitors feature weak coordinated effects but dangerous unilateral effects. One such case is where the investing firm is not the industry maverick. Here, as the analysis of section 2C revealed, coordinated effects are not likely, whereas the unilateral concerns remain intact. Such cases are likely to enjoy a safe haven as Article 81 would be rendered inapplicable. Unilateral concerns also exist in an industry with multilateral passive investment, when a rival company increases its stake in the industry maverick. Here, the ease of tacit collusion remains unaffected by the transaction, and, again, the unilateral threats remain intact. The model of multilateral passive investment also unravels a third example in which only unilateral effects exist: when the industry maverick has no direct or indirect stake in the investing firm.[83] Here too, however, the predictions regarding the unilateral effects of passive

[80] Case IV/34.857, *BT/MCI* [1994] OJ L 223/36, para 44.
[81] Ibid, para 44 (emphasis added).
[82] Ibid, paras 44 and 45.
[83] See Gilo, Moshe and Spiegel, above n 3.

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investment remain. Finally, section 2C also unraveled cases in which passive investment might even hinder the ability tacitly to collude, by softening the threat of price wars. This may occur, as discussed above, in markets with differentiated goods, markets in which firms strategically choose quantities, or markets with capacity constraints. In these cases, obviously, a claim of facilitating collusion could be very weak, while the unilateral effects of passive investment may well be strong. On the contrary, the less likely tacit collusion is to occur, the more probable are the unilateral effects, as by definition they take place when the industry is not in a collusive state.

Accordingly, the narrow application of Article 81 EC in the case law would only partially address the gap left by the ECMR. Such an application follows the ECJ's focus on cooperation and control in the *Philip Morris* case. Consequently, Article 81 EC could potentially cover cases where passive investments falling short of establishing *control*,[84] facilitate coordination or enable *some* influence. Yet, it is not applicable to passive investments which give rise mainly to unilateral anticompetitive effects. Under such a narrow reading, the unilateral effect described in section 2 above would escape scrutiny by Article 81 EC.

C. *Article 82 EC*

In some cases involving unilateral effects, Article 82 EC may be applicable to passive investment and may thus partially assist in filling the gap left by Article 81 and the ECMR. However, such application is limited to cases where the undertaking involved is dominant and the acquisition of minority shares constitutes an abuse of a dominant position.

In the *Philip Morris* case, the ECJ held that Article 82 could apply to the acquisition of minority shareholdings when the shareholding allows the dominant undertaking to influence the commercial policy of the target company.[85] This ruling widened the capabilities of EC competition law to monitor minority shareholdings. In *Warner Lambert/Gilette*[86] the Commission held that Gillette, the dominant undertaking in the community market for wet-shaving products, abused its dominant position. The transaction involved a series of agreements leading to the sale by SKB AB of the Wilkinson Sword wet-shaving business in Europe and the US to Eemland (a shell company used for the buy-outs), and the sale of the business in the rest of the world to the Gillette Group. The transaction included several agreements between Gillette and Eemland. Additionally it involved an acquisition of 22 per cent of Eemland's equity by Gillette, which was also one of Eemland's major creditors. The Commission found this to increase Eemland's financial dependence on Gillette. This, coupled with other aspects of

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[84] Establishing control would bring the transaction under the ECMR jurisdiction.
[85] Above n 64.
[86] Cases No IV/33.440, *Warner-Lambert/Gillette and Others*, and Case No IV/33.486, *BIC/Gillette and Others* [1993] OJ L 116/21.

the agreement, was found by the Commission to form part of a strategy by Gillette to weaken competition in the market, and correspondingly to strengthen Gillette's own position. Gillette's involvement in the buy-out of the Wilkinson Sword business by Eemland was found to breach the special responsibility of a dominant undertaking not to allow its conduct to impair genuine undistorted competition in the common market:

> [T]he structure of the wet-shaving market in the Community has been changed by the creation of a link between Gillette and its leading competitor. ... The change in the structure of the wet-shaving market brought about by Gillette's participation in the overall arrangement will have an adverse effect on competition in that market in the Community and therefore Gillette's involvement constitutes an abuse of its dominant position.[87]

In its decision the Commission held that, following the transaction, Gillette would have the ability to exercise 'at least some influence on Eemland's commercial policy' as a result of it becoming Eemland's major shareholder and largest creditor.[88] This was enough to satisfy the Commission that the threshold indicated by the ECJ in the *Philip Morris* case for application of Article 82 was met.[89]

It is interesting to note that in this case the Commission established 'some influence' by referring, among other factors, to the financial dependence of the target company. The transaction did not involve granting voting rights, and influence was established based on economic reasoning. The Commission's reliance on such implicit influence may be seen as a wider test relative to the one prescribed by *Philip Morris*.[90] The standard for 'some influence' applied in Gillette seems to provide for the application of Article 82 to small minority shareholdings when they provide an acquirer that is dominant in its market with some level of either *de-jure* or *de-facto* influence.[91]

As seen above, Article 82 may assist in bridging part of the gap left by the ECMR and Article 81 EC. Yet its practical application is rather limited. First, the Article only applies to transactions involving a dominant acquiring company. Second, the mere holding of minority shares cannot itself be regarded as abusive. The cases imply that Article 82 is only applicable to circumstances where the acquisition of minority shares enables the dominant firm indirectly to influence its rival's actions.

[87] Ibid, para 23.

[88] Ibid, para 24.

[89] Although the two cases share many similarities, one should point out two main differences. First, in *Gillette*, the acquiring undertaking was dominant whereas in *Philip Morris* it was the target company that was dominant. Second, whereas Philip Morris obtained voting rights in Rothmans, Gillette did not have such rights in Eemland, but rather exercised 'indirect influence'.

[90] On the expansion of the *Philip Morris* standard in the *Gillete* decision, see B.E. Hawk and H.L. Huser, above n 68.

[91] Even when Article 82 EC may apply in principle, its application may be limited by the ECMR. Cases involving decisive influence will come under the exclusive jurisdiction of the ECMR. As a result, Art 82 EC would be applicable to the limited scenario where 'some influence' (*Philip Morris*) does not amount to 'decisive influence' (ECMR). See Art 22, Council Regulation 139/2004.

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The economic analysis in section 2 above highlights the potential anticompetitive effect that remains unchallenged under Article 82. A mere *passive* investment by the dominant firm creating no influence (neither direct nor indirect) would be outside the scope of Article 82. Investment by a non-dominant firm would similarly be outside the scope of Article 82. In the *Gillette* case, for example, even if Gillette were a significant, but non-dominant firm, and even if the Commission would not have found any level of direct or indirect influence granted by Gillette's stake in Eemland, the economic analysis of section 2 above reveals that the transaction could have possessed both coordinated and unilateral anticompetitive effects. As in the cigarette industry discussed in *Philip Morris*, the wet shaving industry is also an oligopoly characterized by product differentiation. Accordingly, unilateral effects of even 'pure' passive investment among major competitors, of the magnitude exhibited in the *Gillette* case, are likely to be substantial.

4. *Bridging the Gap*

From the above, it appears that partial share acquisitions are likely to remain unchallenged when they either: (a) fall short of establishing *control*,[92] (b) do not facilitate coordination or *some influence*,[93] or (c) do not form part of a wider scheme of abuse by a dominant acquirer through indirect influence.[94]

Passive investments involving solely unilateral effects would therefore remain unchallenged in most cases. The economic analysis described above in section 2 accentuates the potential benefit in addressing this gap. As noted, potentially many cases exist where unilateral effects are the main concern as opposed to coordinated effects. Moreover, even in cases that are challengeable via Article 81 due to suspected coordinated effects, the additional unilateral effects in these cases would be ignored, as Article 81 could not address them. Indeed, in a typical case of passive investment among significant players in an oligopolistic market, both concerns arise. While the probability of sustainable collusion is higher, the chance that collusion would break down would still be significant. After the break down of collusion, the prices that would prevail in the industry would be expected to be higher due to the unilateral effects of passive investment.

If one accepts that in certain market conditions, passive investments among competitors result in an anticompetitive effect that merits regulation, then one should explore ways to prevent such transactions from falling outside the realm of EC competition law.

Out of the three possible tools that could deal with passive investments (the ECMR, Article 81 and Article 82), the ECMR provides the most comprehensive

[92] Where the European Merger Regulation would apply (as long as the Concentration has a Community Dimension).

[93] Where Art 81, EC would apply.

[94] Where Art 82, EC would apply.

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application. While considering the possibility of widening the scope of the ECMR to cover passive investments, the European Parliament Committee on Economic and Monetary Affairs took into account the need to refrain from over-regulation and excessive burdens on undertakings, on the one hand, and echoed concerns over the anticompetitive effects of passive investment, on the other.[95]

A possible proposal for reform should take into account the concerns of over-regulation and increased burdens for undertakings. At the same time, it should attempt to provide a flexible regulatory mechanism that may be applied to different types of passive investments. In many ways, the ECMR provides a tempting platform to address passive investments and especially their unilateral effects.

First, the type of economic analysis required for the investigation of passive investments among competitors is similar to that required for the investigation of horizontal mergers. As passive investment among competitors, horizontal mergers too, raise unilateral ('non-coordinated') and coordinated effects, as acknowledged in the Commission's horizontal merger guidelines.[96] Moreover, the unilateral effects of horizontal mergers are similar to those of passive investment: merging firms cease to compete with each other, thereby inducing them to raise prices. This, in turn, may trigger a price raise by rival firms as well.[97] As discussed earlier, a similar analysis applies to passive investment: the investing firm would likely raise prices and this may induce rivals to raise prices as well.[98] The coordinated effects of passive investment are also similar in nature to those of horizontal mergers. Both kinds of transactions might make collusion more stable by making price-cutting less profitable and might also raise the collusive price.[99] In both cases, assessment of the coordinated effects of the transaction involves an examination of the market characteristics that make collusion more likely.[100] As with passive investment, horizontal mergers in oligopolistic markets may raise substantial competitive concerns even when a dominant firm is not involved or does not evolve from the transaction.[101]

In the assessment of horizontal mergers, the structure of the market is a primary tool: the larger the merging firms' market shares the more likely the merger will raise anticompetitive concerns.[102] A similar policy tool should be applied to the assessment of passive investments: the larger the investing firm's market share, the more likely it is that this firm possesses market power in the first instance. As noted in section 2B above, the unilateral effects of passive investment depend on firms possessing market power prior to passively investing in a

[95] European Parliament Committee on Economic and Monetary Affairs Hearing on the Green Paper on the Review of Council Regulation 4064/89, April 15, 2002.

[96] See Guidelines on the Assessment of Horizontal Mergers under the Council Regulation on the Control of Concentrations between Undertakings [2004] OJ C31/03), s 22.

[97] Ibid at s 24 and n 28.

[98] Ibid, section 2A.

[99] EC Horizontal Merger Guidelines, above n 96 at s 39, section 2B above.

[100] EC Horizontal Merger Guidelines, ibid at ss 42–57.

[101] EC Horizontal Merger Guidelines, ibid at s 25 and Recital 25 of Council Regulation 139/2004.

[102] EC Horizontal Merger Guidelines, ibid at ss 17–18, 27.

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competitor. Furthermore, firms with small market shares (e.g. below 10 per cent) are unlikely to be maverick firms if they do not have the capacity to price-cut, expand, and shift market shares from their rivals. Accordingly, the coordinated effects involved in passive investment by a small firm, with a small potential for expansion in the near future, are small. The market share of the firm in which the passive investment has been made is also important. The larger this market share is, the more the investing firm has to lose from competing more vigorously and hence the stronger the anticompetitive effects of passive investment.

Another essential parameter for the assessment of horizontal mergers is the number, market shares and capacities of rival firms not involved in the merger.[103] The more significant these rival firms are (and the more numerous they are) the smaller the anticompetitive concerns, since these rival firms could help constrain the merged entity's ability to harm competition. The same is true for the assessment of passive investment. The anticompetitive effects of passive investment by a certain firm are weaker the larger the market shares or capacities of firms not involved in the transaction and the more numerous they are, as they would tend to constrain the ability of the investing firm to raise prices.

In the assessment of the market's structure before and following a horizontal merger, the Commission often uses the Herfindahl-Hirschman Index (HHI).[104] A similar index could be used to assess passive investment. In fact, the Commission has already used a 'modified' HHI to assess the competitive structure of markets with cross shareholdings.[105]

Furthermore, the assessment of horizontal mergers, similar to the assessment of passive investment among competitors, hinges, among other things, on the identity of the maverick firm (the firm most eager in the industry to deviate from a collusive price). Accordingly, in both cases, competition authorities should seek to identify whether the transaction under investigation involves the industry maverick. As noted, the EC's horizontal merger guidelines stress that *merger* with a maverick firm is especially harmful to competition.[106] As noted above passive investment *by* a maverick is especially harmful, as opposed to passive investment *in* the maverick, which usually has no coordinated effects.

There are a host of other close similarities in the assessment of passive investment and horizontal mergers such as the need to examine consumers' high switching costs,[107] or rivals' capacity constraints,[108] which exacerbate the anticompetitive effect. Additionally, in both kinds of transactions countervailing buyer power[109] or

[103] EC Horizontal Merger Guidelines, ibid at s 17. Of course, in order to determine who the rivals of a firm are, the relevant market needs to be defined (see ibid at s 10(a)), just as should be done in the case of passive investment.

[104] Ibid at ss 19–21.

[105] Ibid at s 20(c) and n 25, citing Case IV/M.1383, *Exxon/Mobil*, point 256, in which the modified HHI index was used. See also Bresnahan and Salop, above n 13, who developed such a modified HHI.

[106] EC Horizontal Merger Guidelines, above n 96 at ss 20(d) and 42.

[107] Ibid at s 31.

[108] Ibid at ss 32–5.

[109] Ibid at ss 64–7.

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low barriers to entry[110] may alleviate the anticompetitive concerns. Also, as horizontal mergers,[111] passive investments may possess horizontal anticompetitive effects even when the parties are only potential competitors.[112]

In addition to the similarities in analysis, the substantive test in Article 2 ECMR provides for the regulation of both unilateral and coordinated effects and could extend to cover passive investment. This would enable the use of the ECMR for monitoring the complete range of effects stemming from passive investment. Recital 25 ECMR clarifies the realm of this test:

> Many oligopolistic markets exhibit a healthy degree of competition. However, under certain circumstances, concentrations involving the elimination of important competitive constraints that the merging parties had exerted upon each other, as well as a reduction of competitive pressure on the remaining competitors, may, even in the absence of a likelihood of coordination between the members of the oligopoly, result in a significant impediment to effective competition. The Community courts have, however, not to date expressly interpreted Regulation (EEC) No 4064/89 as requiring concentrations giving rise to such non-coordinated effects to be declared incompatible with the common market. Therefore, in the interests of legal certainty, it should be made clear that this Regulation permits effective control of all such concentrations by providing that any concentration which would significantly impede effective competition, in the common market or in a substantial part of it, should be declared incompatible with the common market. The notion of "significant impediment to effective competition" in Article 2(2) and (3) should be interpreted as extending, beyond the concept of dominance, only to the anti-competitive effects of a concentration resulting from the non-coordinated behaviour of undertakings which would not have a dominant position on the market concerned.[113]

In addition to these advantages, the ECMR provides the Commission with more flexibility upon finding the transaction anticompetitive. Whereas under Article 81(2) the transaction would automatically be void and both the investor and seller of the shares would be deemed co-conspirators, under the ECMR the Commission may explore different ways to remedy the anticompetitive effects. This may provide protection to the seller of the shares, who may well be an innocent by-stander not linked to the anticompetitive effect.[114]

At present, as highlighted above, the ECMR is limited in it application to minority share acquisitions. This is due to its reliance on *control* to assert jurisdiction.[115]

[110] Ibid at s 68.

[111] Ibid at ss 58–60.

[112] If a potential entrant into a market passively invests in a firm operating in this market, it may refrain from entering the market since such entry would lower the value of its investment. See Reynolds and Snapp, above n 13 at 150.

[113] Recital 25, Council Regulation 139/2004.

[114] See Art 81(2), Treaty Establishing the European Community; Art 7, Council Regulation 1/2003 (providing the Commission with the authority to impose behavioural and structural remedies when Arts 81 and 82 are infringed); Arts 6 and 8, Council Regulation 139/2004.

[115] See the reference to *Concentration* with a *Community Dimension* in section 3 above.

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An attempt to stretch the notion of decisive influence (*control*) under the ECMR to include passive investments should be avoided. Such a solution would blur the criteria for prior notification of the transaction under the ECMR and would affect the legal certainty for undertakings. Additionally, it would result in superfluous, unnecessary prior notifications, adding burden to the Commission and the undertakings involved.

A possible alternative that may allow the application of the ECMR to passive investments is explicitly to widen the scope of the ECMR to cover the more problematic cases of passive investments. The solution may be found in widening the ECMR's jurisdiction while providing for an exclusive appraisal route for passive investments falling short of *control*. Such a proposal should aim, however, to avoid disproportionate regulation that unjustifiably cuts deep into the freedom of investment. Therefore, rather than the *ex-ante* monitoring involved in prior notification that is applied to transactions involving decisive influence, passive investments could be assessed by an *ex-post* analysis. Moreover, the Commission's power to conduct such an *ex-post* analysis would only be available in markets in which the level of concentration and the level of passive investment exceed a pre-defined threshold.

The benefits usually attributed to an *ex-ante* mechanism are less relevant to passive investments, as the remedies imposed by the Commission would not involve a difficult de-merging exercise, but rather just a sale of the minority shareholding.

Accordingly, a dual threshold for empowering the Commission to intervene based on the level of shareholding in a competitor and the level of market concentration, could apply to transactions with a *Community Dimension* falling short of a *concentration*. In these cases, prior notification would not be required. The *ex-post* review would be prompted by the Commission in exceptional cases, where concentrated markets are suspected of being substantially harmed by passive investments.

As highlighted above, the new route would not impose new burdens on undertakings or prompt additional notifications. Such widening of the ECMR jurisdiction may also assist in safeguarding the integrity of the term *control*, thus retaining clear thresholds for prior notification and assessment of mergers under the ECMR.

In the proposed *ex-post* assessment of passive investments, the Commission could utilize clearer evidence of a possible anticompetitive effect. For example, if several years have passed between the passive investment and the ex-post examination, the Commission could make its intervention contingent upon an empirical examination of the industry inquiring whether the passive investment is the cause of higher prices. This possibility for more careful scrutiny of passive investments is available, of course, only under a regime of *ex-post* examination, as in the *ex-ante* stage the data required for such an empirical examination would not be available.

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Clearly, this proposal is not problem-free and would require selective application of the ECMR provisions and evaluation of adequate procedures, remedies and penalty regimes which may suit the new *ex-post* route. It would also require careful consideration of the proper level of scrutiny *ex-post,* and the direct and indirect costs stemming from such intervention. Nonetheless, if carefully crafted this solution may provide an effective and proportionate tool for the regulation of passive investments falling short of *control.*

5. *Conclusion*

In this article we explored the potential anticompetitive effects of passive investments among competitors and the way in which they are regulated under EC Competition law. We have identified a regulatory gap that enables passive investments which result in pure unilateral effects to remain unchallenged. To address this regulatory gap we considered an alternative *ex-post* route under the ECMR that may provide a proportionate tool for the regulation of passive investments falling short of *control.*

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