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EU Competition Law, the scope of Merger control and the defence industry: analysis of case law and methodology

Keywords: Competition law, European law, Defence industry, Member States, Treaty on the functioning of the European Union, Article 346, States buying power, European countries

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Abstract

This essay will consider the mechanisms of European competition law and focus on how Article 346 TFEU and the relationship between the Member States and the European Commission influence the control of the compatibility of military mergers with the internal market. It will argue that because of exception of public safety of Article 21 of the Merger Regulation that allows certain mergers to be cleared on the basis of public security the practice of European competition law has led to a fragile restraint of judicial procedures in the European control of mergers in the defence industry. In response, this essay will suggest a critical approach that recognises the unique characteristics of the defence industry as a central and determinative element in the specific methodology for Competitive analysis of military mergers.

1 Introduction

Since the implementation of the European Economic Community through the Treaty of Rome in 1957, the defence industry has remained on the sidelines of the building of a single European competitive market. As a reflection of the failure of the European Defence Community, the Treaty of Rome acknowledged and protected the national defence since it "inherently belongs to the most sensitive areas of national sovereignty and mostly calls

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on national capacities". [2] Similarly, Article 223 of the Treaty of Rome (Article 346 of the Treaty on the functioning of the European Union "TFEU") sets a derogatory system to the general law of the European Union ("EU") to the benefit of national defence industries. Defence procurement is thus characterised by the persistence of fragmentation of markets along purely national lines.

The end of the Cold War and the move from the Soviet threat to asymmetric risks has led to important changes within the Western defence industry. In the USA, in 1993, the Secretary of Defence led a meeting with the leaders of the US Defence Industry. The sudden decline in defence budgets and the key restructuring announced on this occasion led this event to become famous under the name of "last supper". [3] There soon was some impact: between 1993 and 1998, the American defence industry experienced an unprecedented wave of mergers and acquisitions for a total amount of $ 64 bn.[4]

In the European Union, this consolidation process rather consisted of two separated steps. During the first step, the Member States opened up the capital of the champions of their defence industry and they have promoted the setting up of large military-industrial complexes. In the second step – still ongoing, the Member States have eased the rise of European champions such as EADS, Finmeccanica, BAE System or Thales. At the same time, there has been a shift from a "*state dedicated*" model, where a state with certain defence needs was the only shareholder, the only fund provider and the only client of its national defence industry, to a "*market orientated model*"[5] ruled by both supply and demand. In such circumstances, the defence companies had to diversify their activities by developing the civil side of their military activities. This is through this significant restructuring process that

2 European Convention, Final report from the Workgroup VIII 'Defence' CONV 461/02, WG VIII 22, 16 December 2002, point 31.
3 D. Fainsilber, « La restructuration à marche forcée de l'industrie de défense américaine »,*Les Echos*, 2 août 1996, p. 4.
4 J.-M. Guéhenno, "The European Commission, Friend or Foe of the European Defence Industry? ", *RMCUE*, n° 433, 1999, p. 672.
5 P. Muller, « The transformation of the Public Procurement through the history of Airbus», *Politics and Public management.*

the European defence industry has faced the European competition law, which it had previously mostly avoided. In such a context, the military sovereignty, inherent to the national defence policy, runs up against the integration process of the European merger control.

For the purposes of clarity and accuracy, certain general principles of merger control regulation[6] need to be recalled. Its purpose is to prohibit mergers and acquisitions that would significantly reduce competition in the single market. For instance, this may be the case in the event where such a merger would create dominant companies that are likely to raise prices for consumers.

This essay will discuss the following topic: how does the European merger control consider the specific case of the Defence Industry? A context of cooperative equilibrium has been established between the Member States and the European Commission. The Member States have used judicial restraint in the use of procedural instruments enabling them to counter the European merger control on defence companies (discussed in section I of the article). Similarly, the European Commission has adopted an adaptive approach suiting both political and economic needs of the defence industry (discussed in section II of the article). It is important to bear in mind that the Member States and the Commission have diverging interests regarding this whole matter, which may potentially lead to conflicts of interest. Indeed, the Member States intend to preserve interests in relation to their national security sometimes at the expense of economic rationality when the Commission works in order to fully implement competition law mechanisms.

6 Council Regulation (EC) No 139/2004.

2 A Fragile Restraint of Judicial Procedures in the European Control of Mergers in the Defence Industry

Despite the existence of procedural instruments that enable the Member States to waive the requirements of the merger control for the sake of their national security (1), the merger control of defence industries is now, in practice, implemented without hindrance from the European Commission (2).

2.1 The Sovereignty Principle Prevailing over the Merger Control Objectives

The EU law sets out two procedural instruments enabling to preserve the military sovereignty of the Member States from the economical rationality of the European merger control. This is the "*exception of defence*" (TFEU, Art 346 (1)) (A) and the exception of national security (Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation)) (B).

A. The "Exception of Defence" (TFEU, Art 346 (1))

Under the terms of the Treaty on the Functioning of the European Union (TFEU), the Member States are required to act fairly, transparently by complying with competition rules at a European Union (EU) level. An exception can be applied under Article 346 TFEU[7] in respect of the "production of or trade in arms, munitions and war material", where a Member State considers it necessary for the protection of the essential interests of its national security. In those circumstances, all Member States can derogate from the EU competition law principles contained in the Treaty to the extent necessary to protect those interests by invoking Article 346 TFEU. The derogations set up in Article 346 are broader than the more usual exceptions to the free movement of goods (Article 36 TFEU), of people (Article 45(3) and Article 52 TFEU), of services (Article 62 TFEU) and of capital (Article 65 (1) b) TFEU). When these latter only set derogations to one of the four

7 Article 346 (1) (b) TFEU underlines that "*any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material*".

fundamental freedoms of the TFEU, the "*exception of defence*" implements a powerful mechanism that sets aside the "*market principles*" and enables Member States to take measures in order to preserve their national security. The Commission has acknowledged in 1994[8] that Article 346 (1) b) TFEU enables the Member States to provide derogation for the European Competition Law. Therefore, the "*exception of defence*" can be raised by a Member State in order to avoid notifying the Commission any merger matching the requirements set in Article 1 Council Regulation (EC) No 139/2004. They are allowed to only notify the civil applications and dual applications (civilian and military) and to preserve the military secrecy through the notification.

Nonetheless, Article 346 (1) b) TFEU does not fully empower the Member States. It is true that the initial reticence of the Commission to act in the area of national defence has led the latter to consider it as an issue of sovereignty.[9] However, it is now accepted that the "*exception of defence*" must be considered narrowly.[10] In *Sirdar v. The Army Board and Co,* the European Community Court of Justice has underlined that the "*exception of defence*" can only be applied to "*exceptional and well-determined situations*". [11] It can then be seen as an "*exceptional and specific*"[12] *derogation which contributes to "the co-ordinate and balance the conduct of the relationships and of the tensions*" between the competition economic considerations and the key stakes of national security.[13]

This tricky operation relies on the two following conditions, which must be confirmed[14] by any State intending to invoke the "*exception of defence*". The first condition regards the nature of the concerned products. These must be of a pure military nature, so that any product with dual application (civilian and military) is automatically excluded from the scope of the "*exception of*

8 Case IV/M.528, *BAE / VSEL*, 24 November 1994. 1, 9 to 11.; Case IV/M.529 *GEC / VSEL*, 7.
9 S. Trombetta, « La protection des intérêts nationaux de la défense. Quand la défense devient européenne », *RMCUE*, n° 490, 2005, p. 442.
10 ECCJ, 16/09/1999, *Commission v. Spain.*
11 ECCJ, 26/10/1999, *Sirdar v. The Army Board and co.*
12 G. Arnoux, *Le droit européen de la concurrence et l'industrie de la défense*, th. Paris I Sorbonne : Droit, 2011, p. 443.
13 10/07/ 2007, *Commission v. Italy.*
14 ECCJ, 16/09/1999, *Commission v. Spain*.

defence". According to the second part of the Article 346 (1) b) TFEU, this restriction aims to avoid that the measures intended to preserve a Member State's essential security interest "*adversely affect the conditions of competition in the internal market regarding products which are not intended for specifically military purposes*".

Moreover, Article 346 (2) TFEU requires the publication of such purely military products on a list drawn up by the Council on 15 April 1958. Never officially published [15] and unchanged since 1978[16], this list has unquestionably aged. It takes no account of the most sophisticated military devices or small arms, which are commonly used by any modern infantry. However, it keeps it binding effect. Thus, in the *Fiocchi Munizioni (2003)*, the Court of First Instance has set that the Article 346 (1) (b) TFEU "*could not as such apply to products other than those identified in the list drawn up by the Council on 15 April 1958*".

This specificity, partially outdated, of the list of 1958 significantly restricts the scope of the "*exception of defence*" since it excludes nearly half of the military markets.[17] For example, in a preliminary ruling from 12 June 2012[18], the EUCJ has required the courts having jurisdiction to look at the list set up in 15 April 1958 in order to figure out the applicability of the "*exception of defence*" to military rotating platforms.

The second condition regards the nature of the aims pursued by the Member States when invoking the "*exception of defence*". According to the TFEU Article 346 (1) (b), in order to use it, it only takes a Member State to argue that the considered measures are necessary and proportionate for the sake of national security. It appears that defining the essential security interest and both the necessity and proportionality of these measures fall under the exclusive sovereignty of the Member States. Whilst the very existence of Article 348 TFEU – which sets a mutual agreement and a litigation proceeding

15 Its content has only been published in the answer to the question E-1324, 01/05/01, raised by Bart Staes to the Council OJEC.
16 It has been actualised in 1978 - E. Mahr, D. Waters, « Member State derogation rights in the area of defence mergers », *Global Competition Review*, mars 2003, n° 6(3), p. 14.
17 J.-M. Guéhenno, "The European Commission, Friend or Foe of the European Defence Industry?".
18 ECCJ, 06/06/12, *Insinööritoimisto InsTiimi Oy.*

in case of misuse of the "*exception of defence*" – is enough for demonstrating that the freedom of Member States is not unlimited in this field. One must, however, underline that the Member States have significant discretionary powers.

The control of the necessity and proportionality and reasons invoked for the measures considered in the name of Article 346 (1) leads the Commission only to rebuke the most blatant cases. Similarly, the ECJ has never condemned any Member State for the use of Article 346 (1), which was not a blatant misuse. This was the case of the Spanish law exempting VAT on both imports and exports of weapons, ammunitions and devices with military-exclusive uses.[19]

B. The Exception of Public Safety of Article 21 Paragraph 4 of the Merger Regulation

The legal framework enabling the Member States to preserve their defence sovereignty is completed by an exception especially applicable to the merger control. Article 21(4) of the Merger Regulation enables any Member State to "*take appropriate measures to protect legitimate interests other than those taken into consideration*" by the Merger Regulation, without prejudice to Article 346 TFEU.[20] The notion of legitimate interest under the Merger Regulation encompasses public safety, media plurality and prudential rules. These three interests enable the Member States to "*take appropriate measures*" without giving prior notice. The notion of legitimate interest also covers any other public interest provided that this latter has been previously "*communicated to the Commission [...] and be recognised by the Commission after an assessment of its compatibility with the general principles of Community Law.*"

As opposed to the "*exception of defence*", these exceptions do not enable Member States to set aside the European Law as a whole but only to neutralize the "*one-stop shop*" required by Article 2 of the Merger Regulation. In other words, Article 21(4) does not enable to opt out part or all of a merger of the Commission control, but only enables the Member States to supplement it with additional national measures – when they are proportionate

19 ECCJ, 16/09/1999, *Commission v. Spain*.
20 Council Regulation n° 139/2004, 20 /01/2004 regarding the merger control.

and necessary to this national security goal. These are primarily prohibitions or restrictions of mergers allowed by the Commission. However, Article 21(4) does not open new rights to the Member States. Thus, it does not enable a Member State to allow a merger forbidden by the Commission beforehand.[21]

In the same way as the "*exception of defence*", the exception of public safety must be interpreted narrowly. In *Enel v. Acciona,*[22] the Commission has constrained its scope for the situations of "*real and sufficiently serious threats affecting one of the fundamental interests of society*". Nevertheless, it remains true that the scope of such a "*vague concept opened to different interpretations*" is significantly broader than the "*exception of defence*" one. Indeed, the exception of public safety covers not only mergers related to "*the production or trade of weapons, ammunitions and war material*" but also encompasses supply security of energy or key products or services. Contrary to regulations and legislation, the impact of the "*exception of defence*" and public safety over controls of military mergers is extremely limited in practice.

2.2 The De Facto Submission of the Military Sector to the European Merger Control

As underlined by Gillian Arnoux, the submission of the defence industry is the result of both the proactive attitude adopted by the Commission since the 1990's (A) and the tacit consent of the Member States (B). [23]

A. The increasing role of dual use goods in the development of military mergers control

According to the European Commission, dual-use items are goods, software and technology normally used for civilian purposes but which may have military applications. At the end of the late 1990s, the Commission has, in practice, worked in order to offset Article 346(1) (b). Dual-use goods have

21 European commission, Proceedings of the Council of Ministers, 21/12/1989.
22 European commission, Proceedings of the Council of Ministers, 21/12/1989.
23 G. Arnoux, « L' exception défense » : Réflexions sur le contrôle européen des concentrations », *2011.*

rapidly expanded in the economy from that time on and the Commission have relied on their task of preventing civil impact related to measures taken on behalf of Article 346(1) (b), in order to extent the scope of their intervention. This extension project emerged as a two-step process.

As a first step within this process, the European Commission worked in order to reinforce their competences for controlling the military and dual use sides of non-exclusive military mergers for which the "*exception of defence*" had not been formally invoked. In *Alcatel/Thomson CSF v. SCS* case,[24] for example, the Commission has required information on the military satellite market, which had not been communicated by the notifying parties, even though these parties did not formally use Article 346(1) (b). When requesting the transfer of military data, the Commission demonstrates its jurisdiction to deal with military mergers in all their aspects. Therefore, it creates a breach in the interpretation of the "*exception of defence*" made by the Member States.

Then, for the second time, the Commission has pursued this line of thinking to its logic end. In Saab v. Celsius,[25] the Swedish government had ordered parties not to notify certain aspects of the merger that related to national security - but only the aspects relating to dual-use goods and to civil use goods. In order to assess the military impact of the notified merger on the non-military sides, the Commission has disputed the use of the "*exception of defence*" and has required information in relation to the defence aspects on the basis that this would not require disclosures that would threaten national security. Therefore, the Commission has been able to control the military markets closely interrelated to relevant civil markets, and, by extension the whole merger. Only three years later, the Court of First Instance backed the interpretation of the Commission with the *Fiocchi Munizioni* decision where they clearly set the principle of the unenforceability of the "*exception of defence*" to mixed-use products.

24 European Commission, 04/06/1998, *Alcatel/Thomson CSF v. SCS.*
25 European Commission, 04/02/2000, *Saab v. Celsius.*

B. The State Acceptance of Military Mergers Control

To a large extent, the Member States have stopped to invoke the "*exception of defence*" following the *Fiocchi Munizioni* decision, while it was fairly common beforehand. Since then, there had not been such a use of Article 346 (1) (b) TFEU through which one or more Member States could have encouraged the parties of a military merger not to notify it at all.[26] Even more important, since then Article 346(1) (b) TFEU has only been expressly invoked twice, in order to prevent either the notification of the military sides of a mixed-use transaction or of few elements of a mixed-use transaction that would imply to disclose military secrets. [27]

It appears that most of the mixed and military transactions exceeding the threshold set out by the Merger Regulation are now entirely notified to the Commission. For example, companies such as SNPE and Safran have notified both the civilian and military aspects of the merger even though they directly concerned highly strategic military products, which may have been covered by the "*exception of defence*".[28] Moreover, with the support of the French government, the Commission has intervened in the context of the merger between DCN and Thales although there were no civilian or dual purposes. [29]

This outstanding marginalization of Article 346(1) (b) TFEU regarding merger controls could have driven forward the exception of public safety. This logic would have implied that the Member States massively used Article 21(4) of the Merger Regulation in order to preserve their military sovereignty while avoiding any confrontation with the Commission by setting aside the European Union Law. However, the Member States have generally preferred to use the ordinary notification procedure rather than the exception of public safety. The exception of public safety has only been rarely invoked under the former Council regulation (EC) No 4064/89[30]. Furthermore, since the entry into force of the new Merger Regulation, the use of

26 The last use of this article dates back to the creation of MBDA in 2001.
27 European Commission, 10/12/ 2004, *ThyssenKrupp v. HDW.*
28 European Commission, 30/03/2011, *Safran v. SNPE Matérieux Energétiques.*
29 European Commission, 19/03/2007, *French State-Thales v. DCN.*
30 Press Release: IP/00/628 en.

the exception of public safety has been scarcer.[31] The generalized lack of interest on the part of the Member States for the exception of public safety is probably due to the fact that this latter is only an imperfect substitute for the "*exception of defence*". Contrary to this latter, the exception of public safety does not allow a state intervention as a complement to the control from the Commission and, therefore, does not enable to prevent disclosing classified information.

That is undoubtedly how the statement of the British Department of Trade and Industry should be interpreted according to which the "*exception of defence*" was more suited than the exception of public safety in order to preserve the national security objectives of the merger between *British Aerospace and VSEL.* However, it is necessary to underline that this general statement does not exclude key differences in the approaches taken by various Member States.

Since the 1990s, the use of the exception of public safety has been almost exclusively used by the UK. The British Department of Trade and Industry has interfered on behalf of the exception of public safety in more than ten mixed or military only mergers, which the Commission cleared without conditions. These interventions were usually about negotiating behavioural commitments regarding both the protection of classified data and the continuation of national strategic capabilities.[32] Conversely, the German government seems reluctant to invoke the exception of public safety. The French approach is much less clear-cut, and harder to interpret. Although France does not have clearly defined policies, it is reasonable to assume that they would, rather, tend to align themselves with the position of the other Member States involved in the merger. This apparent moderation from Member States, however, implies that the Commission has to act with moderation through its control of military mergers.

31 M. Moore, K. Herald, « Defence mergers in practice: recent examples», *Practical Law Company*, September 1, 2006.
32 UK Department of Trade and Industry, Press Release P/2002/754, 27 November 2002.

3. The Control of the Compatibility of Military Mergers with the Internal Market: a Specific Methodology

The Commission have often been accommodating since they have never prohibited any military merger (in whole or in part due to dual use goods) although they have often imposed conditional merger clearances. In *Raytheon v. Thales,* the Commission has even stated that the requirements set out by the parties were not necessary. [33] At first sight, such an accommodating policy is surprising since the defence industry is often pointed at as the showcase regarding imperfect competition where various distortions of competition can be encountered. This seems counterintuitive but the Commission intends to gain confidence of the Member States, and it is precisely why the Commission rarely opposes military mergers. Therefore, the Commission "*endeavours to show that its usual analysis tools may also be applied without damaging the defence industry and that they are able to take into consideration their specific nature*".[34] This "*specific treatment*" takes place in the definition of relevant markets (1) and the competition analysis (2) run by the Commission to the extent that it is likely different from the standard analysis.

3.1 The Definition of the Relevant Military Markets

The markets of the military products (A) and their geographic boundaries (B) reflect the economic and political characteristics of the military industry.

A. The definition of the Military Products Markets

The Commission performs "very precise segmentation"[35] of the military products market. After initially excluding from its analysis the products intended for civilian purposes, the Commission considers the substitutability of defence goods depending on their intended use. The Commission's approach, therefore, is to move forward in two stages. As a first step, they differentiate the military markets relying on the different categories of

33 European Commission, 30/03/2001, *Raytheon/ Thales/JV.*
34 M. Guéhenno, "The European Commission, Enemy or ally of the European Defence Industry? ", *RMCUE*, n° 433, 1999, p. 672.
35 G. Arnoux, *Le droit européen de la concurrence et l'industrie de la défense*, th. Paris I: Droit, 2011, p. 159.

weapons. The Commission considers that each one of them meets specific needs and that these categories are exclusive of each other. Although these categories seem relevant at the first sight, they often come up against some military necessities under which some products belonging to different categories shall carry out comparable or related functions. This is particularly the case of drone planes, which may well be used as air surveillance systems, or as interceptor fighters, among others functions. When faced with products that are functionally equivalent, economic agents make rational decisions based on their preferences and the prices.[36]

When faced with products with equivalent functions, the choice of the consumer constantly relies on his preferences and on the price.[37] However, in military matters, the Commission sometimes seems to underestimate these factors. At first sight, the resulting definition of the market seems disadvantageous to military mergers as it increases the probability of dominant position on the relevant markets. Due to the specific features of the military industry, it seems that the precision of the distinctions established by the Commission has had a completely opposite effect. By limiting the potential overlapping, the methodology used by the Commission indeed reduces the risks of non-competitive effects. These issues are obviously opened to political interpretation. Furthermore, the attempt to mitigate this methodology of delimiting relevant markets, by taking in account the underlying motives of national defence choices, could be seen as an encroachment on the competencies of Member States. By limiting its analysis to the category of military devices, which is then considered independent, the Commission seems to avoid any impact on national defence choices. However, this methodology used by the Commission may still someday impact on national defence choices. Indeed, as the mergers within the defence industry will grow more important, the overlapping risks will also grow more important in the most narrowly defined markets.

In the second phase, the Commission again divides these main categories. Regarding the prime contractor level for military equipment, the distinc-

36 Report of the Commission on the definition of markets regarding the European Competition Law (97/C 372/03), point 13 and 18.

37 A New Approach to Consumer theory, Journal of Political Economy, 74, 1966 et: Consumer Demand, A New Approach, New York, Columbia University Press, 1971.

tion of this category is based upon functional and technological differences between the products. In *Preussag/Babcock v. Celsius*, the Commission held that it was necessary to distinguish between the sub-markets for military submarines and pocket submarines. However, on the military equipment level, the Commission uses an even finer distinction as it distinguishes the markets by the component.

B. The Geographical Distinction of Military Markets

In civilian sectors, the geographical distinction of markets usually relies on factors such as the cost of transportation, national preferences or even national legal barriers. According to the Commission, the defence industry once again seems to depart from the general rule due to its economic and political specificities.

In this regard, the Commission alternatively considers national or global markets. Since its 1991 decision *Aérospatiale/MBB*, the Commission considers that the key criterion was the existence of a national provider. When the Member States dispose of national producers on a specific defence market, they tend to have a clear preference to select national providers.

In such circumstances, cross-border military mergers would not result in overlapping situations in this market. However, the Commission considers that it is necessary to differentiate between national markets "*for the defence equipment and sub-systems (…) for Member States in which national producers exist*".[38] As an example, the decision regarding EADS in 2000 contemplates the need for differentiating between relevant national markets in the Member States, in which there are suppliers to clean helicopters.[39] This decision also underlines the importance of the global market for civil helicopters. Conversely, the Commission considers geographical markets with global dimension when the Member States do not have the possibility to buy from national suppliers at their disposal. In *ThyssenKrupp v. HDW* case, the Commission has considered that the submarines from any country belonged to an open global market unless they come from countries with their own

38 European Commission, 07/02/ 2006, *EADS/BASE*, point 10.
39 European Commission, 11/05/ 2001, *EADS*, point 58.

national producers or which are not open to western producers.[40] Indeed, in the USA, the Arms Export Control Act (1976) enables the President to restrain or block certain exports or imports of military devices. This remains a strong barrier to the access to the American defence markets. However, the Commission has seriously considered putting in question its traditional approach since a decision regarding EADS in 2006.[41]

The Commission considered that the political initiatives taken by the European Union in order to open the military markets of the Member States could potentially lead to a geographic European defence market. Since 2006, this trend has got increasingly coherent. Since the Directive 2009/81/EC on sensitive public procurements in the defence and security sectors and Article 346 TFEU regarding defence public procurements, the Commission has therefore intended to establish an increasing amount of rules regarding the tender process in the defence industry. However, this trend to open up military tenders from the Member States to the European Competition is not yet fully reflected in the decision making process of the Commission. Like its methods for defining the relevant markets, the competitive analysis of military mergers method used by the Commission reflects serious attempts in order to adapt it to the political and economic specificities of the industry.

3.2 The Methodology for Competitive Analysis of Military Mergers

The methodology used by the Commission in order to assess the impacts of military mergers is essentially built up around the structuring role of Member States in organizing their defence markets. Insofar as the Member States are monopsonies,[42] the States impact on the structure of defence markets through the organization of military tenders (A) as well as their countervailing power as sole customer (B).

40 European Commission, 10/12/2004, ThyssenKrupp/HDW, point 27.
41 European Commission, 07/02/ 2006, *EADS/BASE*, point 10.
42 A monopsony is a market form in which only one buyer faces many sellers. The term was first introduced by Joan Robinson in her influential book, *The Economics of Imperfect Competition,* published in 1933. This concept has been further developed in microeconomics with the theory of imperfect competition.

A. The Structuring Role of Monopsonistic States in Military Tenders

Generally speaking, the acquisitions of military equipment belong to competitive procedures set up by the monopsonistic States. Therefore, the competitive analysis of military mergers is influenced by two elements.

Firstly, these competitive procedures are regularly organized and regard long-term contracts. The actual competition between the involved firms only occurs during these timeframes. Both the scarcity and the importance of these contracts imply that neither the market share nor the degree of concentration of the industry at a given time reflects the level of activity of a company and ignores the potential competition. Therefore, the classic criteria such as the cumulative market shares or the general degree of concentration of relevant markets only have a secondary role in the competitive analysis of military mergers. However, regarding the cumulative market shares of the notifying parties, the Commission considers that their sole level can be considered as an indicator for the existence of a dominant position.[43]

On military matters, however, as she proceeds with other tenders, the Commission underlines that "*the sole market shares do not constitute reliable indicators for the real market power of the companies involved*".[44] In a recent decision on *Safran/SNPE*, for example, the Commission considered that the importance of cumulative market shares of the parties – from 70% to 90% in France or in the United Kingdom – was not such as to impact on the competition in the market of solid rocket motors.

Hence, regarding the general degree of market concentration as measured by the Herfindahl-Hirschmann Index (HHI), it does not seem to influence the Commission's competition analysis either. Should the Commission consider that the HHI "*can give an initial indication of the competitive pressure in the market post-merger*" they rarely refer to it in order to assess the impact of a military merger on the competition. Furthermore, even assuming that they would have implicitly included this criterion in their analysis, its im-

43 European Commission, Guidelines for the appreciation of horizontal mergers as regards to the Council regulation on the control of company mergers, point 14.

44 Case 26/76, Metro SB-Großmärkte GmbH & Co. KG v Commission of the European Communities ('Metro No. 1'), [1977] ECR 1875, para. 13.

pact would still be secondary. For example, the merger between Safran and SNPE only regarded the already highly concentrated for tactical missiles. Given the parties' position on the market, there is little doubt that the HHI, which was already high, had significantly increased post-transaction. However, the Commission has not attached any condition to its decision. On the other hand, the structuring of the military markets by tendering enables the States to exert significant influence over the competition in defence markets. In their tendering procedures, the Ministries of Defence have, from a strict economical perspective, interest in selecting the offer whose price is the most competitive instead of opting for the outgoing. For example, following a recent tendering procedure, the Belgian federal police have decided to replace the pistols produced by a Belgian company with American pistols. Therefore, any tendering appears to be a new opportunity for each competitor to reinforce its position in the relevant market.[45]

Moreover, the degree of openness of tendering procedures and their timetable usually enable new actors to become key players in the future. However, the problems inherent to the access to defence technologies but also the reluctance of the States to award defence contracts to companies with no experience in this field constitute high barriers to entry or expansion by outsiders. Nonetheless, by sponsoring new entrants and by participating in the co-development of cutting edge technologies, they can however ease the expansion or the creation of reliable actors.

B. The Compensatory Role of the Monopsonistic States Buying Power

In the early stages of the civil merger control, invoking a compensatory role of the monopsonistic states buying power was frequently a way of minimizing the risks of anti-competitive effects. However, this concept has received less attention as the competition authorities refined their analytical methodology.[46] On defence matters, the Commission has systematically entitled it considerable importance; up to consider the opinions expressed by the Defence Ministries concerned. In its decision on *Safran / SNPE,* the Commission referred to the fact that the French Defence Ministry opinion in

45 European Commission, 16.5.2004, General Dynamics/Alvis.
46 J. Taladay, "Buying Power: a Star is (re)born", Concurrences, May 2011, n °2.

order to set aside potential competition problems related to the high market share of the entity resulting from this merger. [47] As sole clients for defence equipment for which they set their criteria, the States benefit from a unique buying power that enables them to counterbalance the horizontal effects of military mergers.[48]

The monopsonistic nature of the defence industry and the relative scarcity of tenders lock the companies of the defence industry into an economic dependence that prevents them from freeing themselves from the competition rules, otherwise they could potentially find themselves set aside from their only customer. This is especially true when it comes to European actors who do not benefit neither from size effects nor from the political influence of their American rivals.

Besides, the fact that the States often have research and development ("R & D") capacities or access to key defence technologies sometime enable them to organize the entry of new competitors. As modern defence devices get increasingly sophisticated, complex and expensive, the fact that the States have the capacity to create new competitors becomes an issue – since it creates an asymmetry with large American groups, which could eventually become a problem. The counterbalancing buying power of the States also exists when it comes to the impact of vertical mergers. In theory, companies that vertically integrate may make use of their dominant position in this market in order to impose disadvantageous conditions on their competitors in the downstream market. Therefore, these competitors do not have any other choice except supplying themselves from their vertically integrated competitor. In the defence industry, the structure of the tenders multiplies the buying power of the States while the initial goal of such a process was to minimize this risk. In principle, the States can intervene and constrain the applicant companies to obtain their supplies from suppliers that are not fully integrated and set themselves the characteristics of the devices they ought to buy.[49]

47 European commission, 30/05/2011.
48 European Commission, 28/04/1999, Matra/aérospatiale, pt 39.
49 G. Arnoux, *Le droit européen de la concurrence et l'industrie de la défense*, th. Paris I : Droit, 2011, p. 249.

Therefore, the States can contribute to preserve alternative suppliers in order to prevent anti-competitive vertical effects. As underlined by the Commission in the *Safran/SNPE* case, the risks of crowding-out are reduced when it is in the best interest of the States to pull these levers in order to avoid an increase of the prices at any stage of the value chain. It is only in the case where the company resulting from the contemplated merger would end up being in a quasi-monopolistic situation on an upstream market, without any significant competitor, that the Commission could eventually underline a risk of distortion of competition.

However, when it comes to the markets in which the large US players might get involved, the actual monopolistic situations are very rare unless one considers the existence – very real – of export restrictions on US competitors. With a few exceptions, the Commission has been reluctant to intervene in vertical mergers where military contracts or even defence related activities were at stake, even though market shares were significant.

In summary, the very existence of the European military merger control relies entirely on a cooperative equilibrium between the Commission and the Member States. This equilibrium allows preserving their sovereign powers while ensuring a rational competition in military mergers. However, it is by no means clear whether this equilibrium is sustainable in the long term. Most notably, the economic crisis within the Eurozone has obliged the Member States to more drastic cuts in military budgets. As Alain Juppé, former French Minister of Defence, noted in a report on the European Union, the policy of austerity creates an environment conducive to the Member States bringing together efforts to increase the efficiency of military spending.[50] The quest for large economies of scale and to reduce costs could lead to a new merger wave in military matters that would have a truly European dimension. This could also press ahead with new common purchasing systems for military devices and increasingly integrated set of tenders. However, this trend is increasingly at odds with firmly national exceptions of defence and public safety.

50 Alain Juppé, quoted in L.Verhaeghe, « La crise budgétaire : une opportunité pour accélérer la construction européenne » http://www.defense.gouv.fr/actualites/articles/la-crise-budgetaire-une-opportunite-pour-accelerer-la-construction-europeenne

As the European integration process explores ways to deepen this relationship, these two concepts shall become increasingly irreconcilable. Secondly, it is difficult to imagine that the Member States remain inactive when faced with increasing asymmetry that would favour large American actors or the recent rise in the defence industry of the BRICS. It is questionable, and very unlikely, that the Member States would accept to leave to the wisdom of the European merger control to defend the security interests assuming control by a new entrant. In other words, the cooperative equilibrium faces an instable future.

In such circumstances, if necessary, there would be scope for a re-design of government procedures aiming at preserving public safety interests of the Member States. It is for instance possible to organize a European control of investments from outside Europe in the European defence industry. For this purpose, the Member States could build on the US *'Foreign Investment and National Security Act'* of 2007 that has created a special committee to approve any foreign investment that may have an impact on public safety matters. If the European Union continues on this current track, in the absence of further reforms, it could lead the Commission to give an increasingly important role to political compromises, at the expense of a sound competition public policy, to avoid the upset against the Member States.

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