

**THE ORIGINS OF EU MERGER CONTROL:  
Insights from Agency Theory**

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## I. INTRODUCTION

*Council Regulation 4064/89 on the Control of Concentrations between Undertakings*, commonly known simply as the Merger Regulation (MR), represents a watershed development in the history of the European Union's competition policy regime. The MR not only introduced a new Community competence, but in so doing it affected a significant transfer – or delegation – of authority from member states to Community institutions. The chief beneficiary of this delegated authority was the European Commission.

Among the many reasons offered for the decision to give merger control a Community dimension was the desire to a degree of coherence and legal certainty to a regulatory function that was destined to be of growing importance as firms sought to adjust to the new competitive realities associated with the completion of the internal market.<sup>1</sup> Prior to passage of the MR, merger control fell formally within the remit of national competition authorities (NCAs). The Commission, though possessing extensive regulatory authority in other areas of competition policy, had no formal statutory authority in merger control. That is not to say that it had none at all. Through the creative interpretation of the authority it possessed in other areas of competition policy – namely, the authority to prohibit anti-competitive cartels (Art. 85 [81]) and abuse of dominant position (Art. 86 [82]) – the Commission had carved out a degree of *ad hoc* merger control authority. A side effect of these efforts, however, had been to further muddy the already murky regulatory waters. Firms engaged in cross-border merger activity not only had to navigate disparate national merger control regimes, but they also faced the prospect of Commission involvements.

The merger control regime introduced by the MR represented an improvement on the *status quo ante* in three ways. First, it clarified jurisdictional boundaries. Concentrations would remain under the authority of NCAs *except* those meeting certain threshold requirements.<sup>2</sup> Those meeting the thresholds were considered to have “a community dimension” and would, as a consequence, fall within the sole jurisdiction of Community authorities. Second, the MR created a one-stop-shop. The European Commission was endowed with exclusive competence to evaluate those mergers having community dimension.<sup>3</sup> Concentrations were thereby relieved of the need to seek regulatory approval by NCAs. Third, the MR incorporated the principle of a level playing field. Proposed concentrations would be evaluated on the basis of a common substantive test, the so-called “dominance test”.<sup>4</sup>

The passage of the EU Merger Regulation raises a number of interesting questions. Why, for instance, did merger control take on a Community dimension? Or, once the desire for Community merger control was acknowledged, what explains the timing of the regulation? Why did merger control legislation pass in 1989 when so many previous efforts failed? Who were the

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<sup>1</sup> MR Recitals 2 & 3.

<sup>2</sup> MR Article 1(2)

<sup>3</sup> MR Article 21(1)

<sup>4</sup> MR Article 2

principal actors and what influence did they have over events that led to the passage of the MR? These are all important questions. And each has received attention in the literature.<sup>5</sup>

But there is another, as yet under-explored, puzzle that has not received a similar level of attention. That question goes to the content of the MR itself. Specifically, how are we to understand the mix of provisions that determine the role and responsibilities exercised by the European Commission in merger control? In what way do these provisions reflect member state views on what they regarded as the appropriate relationship between national and supranational authority - as embodied in national competition authorities (NCAs) and the Commission respectively? On the one hand, the MR seems to acknowledge the importance of supranational regulation in this area of economic activity. By any measure, the authority member states vested in the Commission over mergers is considerable. Some have described, somewhat pejoratively, Commission authority as that of investigator, prosecutor, judge, jury and executioner all rolled into one. And, to some degree, the decision by government to empower the Commission in this way is not surprising. If, as events suggest, the principal purpose of establishing a Community merger control regime was to address the legal uncertainties that prevailed under the *de facto* system of merger control, then the creation of a one-stop-shop and a level playing field represents a logical and rational response. And yet, at the same time member governments took positive steps to address the underlying problems, they simultaneously took measures that reduced very the legal clarity and operational efficiency that was supposed to be the hallmark of the system. Significantly, member states constrained the Commission's ability to exercise the very authority that it delegated to the body. That member states decided to do so no doubt says something about what they regard as the appropriate division between national and supranational control. It also suggests something about how member states perceived their relationship with the Commission. Why were such provisions included in the MR? What explains the decision to structure Commission authority in this way?

The central proposition of this paper that this mix of provisions exist for reasons that can be well understood. Part of the answer can, in fact, be found in the existing literature. Previous accounts suggest, quite rightly, that an explanation for the existence of, and some substantive elements contained within, the regulation were the result of intergovernmental bargaining.<sup>6</sup> They also rightly highlight the generative, evolutionary character of events preceding those negotiations. They direct our attention to actions by both the Commission and the Court, actions whose effects can be seen in both the timing and substance of the MR.<sup>7</sup> What these studies generally lack, however, is an analytical framework within which to understand either *why* events unfolded as they did or *how* the events shaped constitutive elements of the MR itself. In this regard, I argue that insights borrowed from Agency Theory may prove helpful. Agency theory draws our attention to the dynamics of authority relations – to the relationship between those who possess political authority (Principals) and those to whom they delegate some measure of that authority (Agents). It thus provides a framework with which to understand the nature of interactions

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<sup>5</sup> See Bulmer (1994), Armstrong & Bulmer (1998), Woolcock (1989), Davidow (1991), Brittan (1991), Schwartz (1993), Goyder (1998: Ch. 18).

<sup>6</sup> See, for example, Woolcock (1998), Schwartz (1993).

<sup>7</sup> See, for example, Bulmer (1994), Cini & McGowan (1998), Goyder (1998)

amongst those actors at the center of merger control story – the member states, the Commission and the Court of Justice. The balance of the article is devoted to developing this argument.

The presentation is structured as follows. The first section provides an overview of the Merger Regulation. It highlights those elements that empower the Commission as well as those that impose restraints on the exercise of that power. The second section provides an exposition of agency theory. Next, I employ agency theory to draw out fresh insights about the history of merger control. The objective is to emphasize the manner in which institutional relationships between member states, the Commission and the Court of Justice shaped the course of merger control and, in particular, the provisions on finds in the 1989 Merger Regulation. I conclude with some reflections on the contribution of agency theory, including a discussion of the limitations of the framework.

## **II. COMMISSION AUTHORITY UNDER THE MERGER REGULATION**

The MR contains two types of provisions – substantive and administrative. Substantive provisions include those that define what constitutes a concentration (Article 3) and the criteria to be used to evaluate whether a concentration is compatible with the common market (Article 2). The other set of provisions are administrative. Administrative provisions complement substantive provisions by outlining the manner in which the latter are to be applied. Three sets of actors figure prominently in the provisions – the Commission, the member states and the Court of Justice. However, it is the European Commission that receives the bulk of the attention.

In line with the principle of a one-stop-shop, the MR endows the Commission with primary authority over all aspects of merger control. Concentrations having a community dimension are required to notify the Commission of the transaction (Article 4). Upon receipt of the notification, the Commission initiates proceedings (Article 6). The first stage of the proceedings involves determining whether a notified concentration has a community dimension and, therefore, falls within the Commission’s jurisdiction (Articles 1 & 5). If it does not, the Commission will so rule and the investigation will end. If it does, the Commission must then decide whether the concentration “raises serious doubts” about its compatibility with the common market. This begins what we refer to today as Phase I proceedings. Concentrations that do not raise doubts during Phase I are declared compatible. Those that the Commission determines raises such doubts are subject to additional scrutiny – so-called Phase II proceedings.

During Phase II the extent of Commission authority over become readily apparent. During these proceedings the Commission engages in an extensive examination of the market conditions to determine whether violates the “dominant position” test. The Commission’s investigative powers are wide-ranging (Article 13). It has the authority to secure all information relevant to the execution of its authority (Article 11), and may, if it deems it necessary, enlist the assistance of competent member state authorities (Articles 12). When it has concluded its investigation and analysis, the Commission takes a decision (Article 8). Where the Commission deems a concentration does not create or strengthen a dominant position, the regulation requires the Commission to the concentration to proceed. Those concentrations the Commission deemed to create or strengthen a dominant position are to be declared incompatible with the common

market and thereby prohibited. Finally, if the Commission finds problems with aspects of the proposed merger, but nevertheless considered the problems remediable, it may conditionally approve a concentration with the qualification that the firm implement certain stipulated modifications. Failure to comply with Commission authority in these matters, moreover, can result in sanctions. Concentrations that fail to notify the Commission of a pending transaction, that supply incorrect or misleading information to the Commission and/or that fail to comply with a Commission prohibition/conditions are subject to fines or periodic payments – the determination of each was also in the hands of the Commission (Articles 14 & 15).

Though the scope and reach of Commission authority over mergers is great, it not unconstrained. Within the MR, one can identify at least three ways in which the Commission's exclusive competence is constrained. The first qualification is *jurisdictional*. The Commission is not at liberty to determine for itself whether a concentration has a community dimension and, as such, falls within its authority. Rather, Article 1(2) establishes threshold conditions that must be met for a proposed concentration to be considered thusly. A concentration meets this threshold *only* if it has a combined worldwide turnover of at least ECU 5 billion, and at least two of the undertakings concerned have a Community-wide turnover of at least ECU 250 million. Also, no undertaking should achieve more than two-thirds of their aggregate turnover within a single member state.

That thresholds of some sort apply is not, by itself, surprising. Unless the Commission was to have responsibility for all merger activity within the Community, quite an unrealistic expectation whatever the prevailing politics, then some line had to be drawn to set a boundary between national and Community control. But, as our later discussion will highlight, the thresholds incorporated into the MR were much higher than the Commission, the business community and, for that matter, many member states wanted. The high thresholds raised the possibility that a substantial number of cross-border mergers which some might regard as affecting community markets would be excluded.

A second jurisdictional constraint is found in Article 9(1). The provision qualifies the Commission's exclusive competence by providing member states a mechanism to request national jurisdiction over concentrations having a community dimension and thus, by virtue of Article 8, falls within the Commission authority. The Commission is, however, not required to grant the referral. It may deny the request or, should it determine that aspects of the merger affect a "distinct market" within a member state, it may refer a portion of the case to the appropriate NCA. Whatever the decision, the Commission must respond to a referral request within time limits stipulated in the provision. Failure to do so results in the referral being granted de facto.

A third constraint is found in Article 21(3). The provision entitles member states to carry out parallel proceedings for concentrations that engage "legitimate interests." Covered explicitly by this provision are mergers relating to public security, plurality of the media, and so-called prudential rules. Interestingly, the provision also includes a residual category "any other public interest" for those matters of national concern not stipulated, but which nevertheless might arise.

The provision empowers governments who find their legitimate interests engaged to prohibit the concentrations *even if* the Commission previously approved it.

In addition to jurisdictional qualifications to the Commission's exclusive competence, the MR also incorporates *procedural* constraints on the Commission. The most significant of these for our purposes is found in Article 19. This provision requires Commission authorities to remain in constant communication with competent member states authorities on matters falling within the MR. Article 19(1) mandates that the Commission transmit pertinent documents relating to notified mergers to relevant NCAs. Beyond that, section 2 requires the Commission to remain in "close and constant liaison" with NCAs in all phases of the merger review process. Part and parcel of this requirement is that the Commission must submit draft merger decisions to an Advisory Committee for consultation. The Commission is instructed to take "utmost account" of the committee's opinion before issuing a final decision and is required to explain to the committee the manner in which its opinion was taken in account.

The final set of constraints are *institutional*. Commission actions under the MR are subject to judicial scrutiny by the ECJ/CFI. For example, Article 16 states explicitly that the Court of Justice shall have "unlimited jurisdiction" to review Commission decisions to fine undertakings for breach of the MR. Under this authority, the Court may cancel, reduce or increase fines. This institutional constraint is in addition to the set of constraints incorporated into the Rome Treaty. For instance, acting under Treaty Article 186 (new Art 243), member states may use the Court to challenge Commission referral decisions taken pursuant to MR Article 9. More generally, Commission action (or inaction) is subject to review under Treaty Articles 173 (new Art 230) and 175 (new Art 232). The former is to address errors of commission, whereas the latter is to address errors of omission. Article 173 provides for annulment proceedings on the grounds of incompetence, infringement of an essential procedural requirement, infringement of the terms of the Treaty, or abuse of power. Article 175 provides a means to sanction the Commission for a failure to act.

That Commission authority is "checked" or "limited" in various ways comes as no surprise, even to the casual observer. Such checks (or balances) are commonplace features of instruments that confer political authority – be it the day-to-day legislation of parliaments, national constitutions, or even international treaties. They are so common that they often pass unnoticed – or, if not unnoticed, unexplored. That is unfortunate. For embedded in these provisions are important insights into relations among political actors; in particular, between those who grant political authority (in this case, member governments) and those to whom it is granted (the Commission). It touches on questions such as - Why was authority granted? What purpose did it serve? Why does it take the form we find? It is with these questions in mind that some scholars have begun to explore the analytical utility of agency theory.

### **III. AGENCY THEORY & THE DYNAMICS OF DELEGATED AUTHORITY**

Political scientists have explored the issue of delegated authority through a number of disciplinary lenses. The study of delegation and agency is perhaps most well-developed in the

study of American politics.<sup>8</sup> However, the framework has also been employed by those interested in public administration and, more recently, it has achieved currency in comparative politics and international relations.<sup>9</sup> Finally, analyses of delegation and agency increasingly inform the study of the European Union.<sup>10</sup>

### **A. Why Delegate?**

The central query posed in the literature is “why delegate?” – why do actors possessing political authority, be they members of parliament or leaders of nation-states, choose to delegate a measure of that authority to another actor? Why don’t they instead act either unilaterally or cooperate amongst themselves in order to achieve their policy objectives?

The leading approach to such questions is provided by rational choice theory.<sup>11</sup> Interestingly, the literature offers no single, clear answer to the question “why delegate?” Rather, one can find in the literature at least four discrete logics of delegation. Each differs in emphasis. Some address the challenges posed by the process of decision-making; others look at the consequences of decisions made. Whatever their focus, however, they all share an instrumentalist perspective on the benefits delegation provides.

The first logic holds that delegation offers a way for actors to deal with *time-inconsistent preferences* and the challenge of *making credible commitments* to which it gives rise. Whether members of parliament or heads of state, actors recognize that agreements between political actors are not always durable. An agreement made is no guarantee of an agreement kept. As a consequence, actors who might otherwise benefit from a political agreement might forego the opportunity for fear of the uncertainty that they will not reap the full benefits of that agreement. The potential sources of uncertainty are many. First, actor interests may change. An agreement that looks attractive today may not seem so forever. Second, the identities of the actors may change (a not uncommon occurrence in democratic polities). Though perhaps valued as a means of keeping politicians accountable, it presents problems for actors who wish to enter long-term agreements. Finally, there is always the chance that conditions unforeseen by the parties to agreement may arise that affect one or more actor’s ability to comply with the terms of the agreement. Whatever the source of this uncertainty, they all have the effect of rendering agreements vulnerable to defection. Aware that such risk exists, actors delegate authority to a third party as means to enhance the credibility of their commitments. Transferring authority to another serves to “tie hands” – by delegating authority actors commit themselves to a course of action that they are unable to alter. In so doing, delegation serves to “lock-in” both the terms of their agreement as well as the benefits expected to be derived there from (Moe 1990).

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<sup>8</sup> Examples include Weingast & Moran (1983), Weingast (1984), McCubbins (1985), McCubbins et al (1987, 1989), Moe (1990a, 1990b), Kiewiet & McCubbins (1991), Epstein & O’Halloran (1999).

<sup>9</sup> In public administration, see, for instance, Horn (1995). In comparative politics, see, for example, Huber & Shipan (2002), Thatcher & Stone-Sweet (2002). In international relations, see, for example, Nielson & Tierney (2003) and Hawkins et al (2006).

<sup>10</sup> See, for example, Pollack (1997, 1999, 2003), Doleys (2000), Majone (2001), Franchino (2002). For a critical view, see Kassim & Menon (2003).

<sup>11</sup> It should be noted that recently constructivist scholars have shown an interest in delegation. See, for example, McNamara (2002).

The second logic focuses on the *efficiency-enhancing* effects of delegation. Whereas the first logic focuses on solving problems that arising from the perceived instability of agreements, this second logic examines problems associated with the process of reaching the agreement itself. The point of departure is the observation that decision-making is an inherently difficult and costly (in transaction costs) activity. The greater the number of actors, the more heterogeneous actor preferences and/or the more complex the issue area, the greater the likelihood that decision-making will grind to a halt. As a consequence, actors who would otherwise benefit from collective agreements may find themselves unable to take the very decisions necessary to realize those benefits. Delegation addresses dilemma of collective decision making by transferring decision-making authority to another for whom the transaction costs are lower. This rationale has been employed to explain, for instance, the creation and utilization of committees by Congress.<sup>12</sup> In this view, committees economize on the transaction costs of decision-making, thereby making it easier for legislators to provide the policy goods necessary to perform their constitutional function and get reelected.

Third, actors delegate authority in order to *increase the quality of decision-making outputs*. It is similar to the second logic in that the focus is on decision making. However, instead of looking to enhance the efficiency of decision-making, actors delegate because they seek to improve the quality of the decisions made (Bawn 1995). Thus, actors look to identify “agents” with the information, knowledge and expertise that they themselves lack.

The fourth logic holds that actors value delegation as a means to *shift blame or responsibility* (Fiorina 1982, Arnold 1990). Sometimes actors forego acting, not because it is costly to do so or because they lack the information to make “good” decisions, but rather they fail to act because they fear the resulting political costs. Delegation, however, provides a means to shift these costs. Delegation can create a measure of political distance between decision-makers and the public exercise of political authority. Public political costs are born, not by the decision-makers, but instead by those assigned the responsibility for carrying-out the policy.

## **B. The Dynamics of Delegated Authority**

Answers to the question “why delegate?” are of limited value by themselves, however. They, in effect, provide only half of the story. This is because, in practice, it is difficult to separate the decision to delegate from the resulting relationship between those who delegate authority (principals) and those to whom authority is delegated (agents). The decision to delegate is shaped in fundamental ways by expectations concerning the likely dynamic between principal and agent. To understand this dynamic, we look at two aspects of principal-agent relationships: a) the amount of discretionary authority enjoyed by the agent, and b) whether principals regard the exercise of that authority as desirable.

The degree of discretionary authority exercised by the agent depends considerably on the underlying delegation logic. Other things being equal, principals seeking to enhance the quality

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<sup>12</sup> See, for instance, Weingast and Marshall (1988), Krehbiel (1991).

of decision outputs are likely to give considerably more discretion to their agents than principals who see delegation as means to shift responsibility. In the former, principals value agents for the value added they offer to decision-making. To overly constrain the ability of the agent to act would threaten to undermine the purpose for which the agent is valued. By contrast, agents whose value is as a political foil are likely to be endowed with far less discretion. After all, their value lies not in any particular qualities the agent may offer. Since there is likely little benefit to be derived from having the agent exercise discretion, principals are disinclined to grant discretion - and thereby risk the hazards that accompany it (see below) - in the first place.

Just as the amount of discretionary authority varies according to the underlying delegation logic, so too does the extent to which principals see the exercise of that authority as desirable. Under most delegation logics, principals regard the exercise of agent discretion as undesirable. Principals delegate authority to agents because doing so serves some specific instrumental purpose, be it to enhance the efficiency of decision-making, enhance the credibility of commitments, serve as a scapegoat, etc. Principals expect agents to take only those actions necessary for the realization of those benefits.

However, once authority is delegated, there exists an inherent risk an agent might act in ways that depart from its mandate. This risk of agent opportunism gives rise to what is referred to as “the principals problem” (Ross 1973). Principals have only imperfect information about the preferences, beliefs, motivations of the agents they utilize. Moreover, they have at best imperfect foresight into the various ways in which their agents might use the authority that is granted pursuant to their role. This results in the risk of agent shirking and agent slippage. Shirking refers to the lack of effort on the part of the agent. Agents shirk to the extent that they fail to perform the tasks assigned in the delegation contract. Slippage, on the other hand, represents an effort by agents to use discretionary to its own advantage. An agent may, for instance, seek to hide information it possesses or conceal actions it takes in order to accrue the benefits derived there from.

Though opportunities for slippage and shirking are endemic, principals are not helpless. Principals employ variety of mechanisms in an effort to “solve” the problem (Kiewiet & McCubbins 1991). One set of responses involves *ex ante* measures designed to reduce the opportunities for shirking or slippage before such behaviors are manifest. Principals may pre-screen agents in order to weed out those most likely to behave opportunistically. Also useful in this regard is the delegation contract – the legal or political instrument through which principals formally transfer authority to the agent. The greater the precision with which agent roles and responsibilities are crafted, the less uncertainties there are for agents to exploit. They may also put in place administrative and/or procedural requirements. For instance, they may require agents to self-report all pertinent activities.

No set of *ex ante* controls, however, can be expected to address all sources of agent opportunism. Information limitations prevent principals from perfectly anticipating all of the ways an agent might shirk. And the mere existence of self-reporting requirements is no guarantee that agents will do so honestly or comprehensively. Therefore, principals employ a range of *ex post* monitoring and control mechanisms. These may include both “police patrols” as well as “fire

alarms” (McCubbins and Schwartz 1984). Police patrols involve the active monitoring of agents for signs of shirking/slippage. However, active monitoring and control of this sort can be costly to principals in terms of time, effort and resources. For this reason, principals complement their own efforts with those of others. They may invite interested parties to act as “fire alarms” when they observe agent opportunism. Once shirking or slippage is identified, principals can apply positive and negative sanctions to bring agent behavior back into line. Finally, principals can introduce institutional impediments to reduce the capacity of agents to shirk. This involves empowering another institutional actors to veto or block the actions of the agent. This last effort represents, in effect, the use of one agent to control another.

What is sometimes lost in models that emphasize conflict and control is that principals may *desire* agents to exercise their discretion. Principals value agents *precisely because* they have preferences different than their own. Given the fundamentally different set of expectations about agent behavior, Majone (2001) has suggested that one should think of delegation under these circumstances, not in terms of principal-and-agent, but as a fiduciary or trustee relationship. The oft-cited example is the delegation of monetary policy authority to an independent central bank. Political authorities want low inflation. However, politics being what they are, politicians must balance the desire for low inflation against other desiderata (such as the desire for high employment). Recognizing their inability to credibly commit to a low inflation monetary strategy, but desiring it nonetheless, political principals take monetary policy decision-making out of their hands by delegating it to an independent central bank. To be credible, moreover, delegation must be comprehensive. Political authorities not only want, but expect, central bank governors to act independently.

The dynamic between political authorities and trustees is one of functional or operational independence. But, does not mean that the principal’s problem is absent? No. Principals still have a desire to see that their trustee acts within its mandate. Thus, principals can be expected to take *ex ante* and *ex post* measures similar to those outlined above. Principals can be expected to take particular care in selecting trustees so as to identify those who might exercise their delegated authority in a manner inconsistent with its mandate. They can also be expected to carefully craft the delegation contract so that the policy objectives are clear and the scope of trustee authority is confined to that necessary to the achievement of the objective. Finally, to insure that trustees conform to their mandate, principals are also likely to employ *ex post* monitoring and control mechanisms. The purpose of such *ex post* controls is, however, different that that associated with the more confrontational model of principal-and-agent. In the case of a trustee relationship, the objective is not to ensure fidelity to principal preferences in any direct and ongoing sense, but rather to ensure fidelity to the policy objectives originally outlined in the delegation contract.

The distinction is a subtle one, but one that is very important empirically. They lead to different expectations about the dynamics of delegated authority. If the adversarial model of principal-agent relations is operative, then we should see principals attempting to keep agent behavior in line with principal preferences. The effort to insure preference compatibility should be evident both in the types of monitoring and control mechanism employed as well as the manner in which they are used. By contrast, the trustee model leads one to expect that principals will design and utilize monitoring and control mechanism with the primary objective of ensuring that their

trustee fulfills its mandate. Active principal control should be in evidence only when the trustee pursues actions that are inconsistent with the policy objectives stipulated in the delegation contract.

#### **IV. THE ORIGINS AND EVOLUTION OF EU MERGER CONTROL**

This portion of the paper provides an overview of key waypoints in the history of community merger control up to and including passage of the 1989 MR. The presentation takes the form of an analytical narrative.<sup>13</sup> The analytical narrative is a variation of a case study method of political inquiry. The purpose of analytical narratives is to “trace the behavior of particular actors, clarify sequences, describe structure and explore patterns of interaction” (Bates et al 1999: 10). It is different from conventional historical accounts in the structure of the narrative is informed by a set of clear fixed theoretical expectations. This allows one to explore consistencies between theoretical expectations and empirical evidence. Though vulnerable to the criticism of “curve fitting” – a criticism to which most case study analyses are vulnerable - evidence of consistency between expectations and evidence provides at least some confidence in the validity of the theory. As employed in this study, the analytical narrative serves two related purposes. The first is to provide a structured account of the unfolding relationship between the member state principals and their agents – the Commission and Court – in the area of merger control. It is done so with an eye to highlighting not only how these interactions influenced the existence of the MR, but how it shaped some of the substantive provisions found within. Second, to the extent that the narrative captures important elements of the merger control “story” not fully captured by other accounts, it provides evidence of the usefulness of agency theory as an explanatory framework.

##### **A. The Delegation Contract: Merger Control, Competition Policy and the Treaty of Rome**

The Treaty of Rome contains no provision for the ex ante appraisal of mergers and acquisitions. Indeed, the Treaty makes no mention at all, implicit or explicit, of the need to address this type of firm activity. There is little doubt that the absence of merger control was intentional (Goyder 1998: 379).<sup>14</sup> There seemed little need for such authority. Merger in the EEC (6) were few in number and those that occurred were largely confined within states. Additional evidence for this position is found in the fact that, at the time, few governments themselves had domestic merger rules. And among those that had merger regimes no government possessed merger control laws designed to curb the anti-competitive effects of concentrations.<sup>15</sup> In fact, far from seeking to forestall industrial concentration, most member states sought to encourage the oligopolization of strategic industries.<sup>16</sup> The French system of indicative planning, for instance, sought explicitly to

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<sup>13</sup> On the purpose and utility of analytical narratives, see Bates et al (1999). Central to the methodology is process tracing – by identifying the relevant actors, the decision points they faced, the choices they made, the paths taken and not taken, and the manner in which their choices generated events and influenced outcomes. On process tracing, see George (1979) and George and Bennett (2005).

<sup>14</sup> For an alternative view, see Downes and Ellison (1991:4).

<sup>15</sup> The Dutch had laws that required firms to notify authorities of pending mergers, but the legal restrictions against concentrations were few (and exemptions to these restrictions were granted liberally). The other founding member states—France, Italy, Luxembourg and Belgium—had no legal restrictions to speak of.

<sup>16</sup> It was not that the Framers did not consider the value of the Commission involvement. In point of fact, member

cultivate national champions through a combination of subsidies, sectoral coordination and selective trade protection. The Italian government likewise encouraged concentration through targeted incentives and extensive state ownership.

That member governments chose not to include merger control provisions in the Treaty did mean that they were unconcerned with anticompetitive firm behaviors and their impact on community markets. Quite the contrary. Member states incorporated into the Treaty elements of a wide-ranging competition policy regime. The core of the rule framework is found within Articles 85 and 86 [new Arts. 81 and 82] in provisions intended to prohibit most forms of collusive firm practices as well as the abuse of dominant position (respectively). To give effect to these rules, member government delegated administrative authority to the European Commission. The extent of this authority was, however, left unspecified. It was not clear within the relevant provisions precisely what actions member governments expected or intended the Commission to take pursuant to its responsibilities. Neither was it clear how the Commission was to carry out these responsibilities. The treaty left these matters for subsequent negotiations.

Though not speaking directly to mergers, Article 85 and 86 nonetheless speak to the types of anticompetitive effects one associates with mergers. Thus, it may seem odd that governments should be concerned with the behaviors, but not to the creation of concentrations that were likely to give rise to them. Nevertheless, there is no indication that member governments intended either article to be interpreted or applied in this way. In fact, the prohibition language contained in each is tailored quite narrowly to address observable firm behaviors and not, as would be the case in merger control, to potential or even likely behaviors. Consider the language of Article 86. Article 86 prohibits the *abuse* of dominant position in community markets. Subparagraphs (a)-(d) then list actions that constitute abuse. However, nowhere within this list is there any suggestion that simply possessing a dominant position was problematic per se. The article is silent on the conditions that might have led to the acquisition of that position. Thus, there seems no basis on which to conclude that member states intended to incorporate merger activity within the meaning of the article or, more importantly, that the member states intended to empower the Commission with the authority to interpret the provisions in that manner.

## **B. 1957-1973: Exploring the Options**

Events in merger control were slow to unfold. For the first fifteen years after the passage of the Rome Treaty member governments took no formal actions in the area of merger control. However, two events occurred that would profoundly influence later developments. The first was the passage Council Regulation 17/62. The second was the publication in 1966 of the Commission's *Memorandum on the Problems of Concentration in the Common Market*.

### Regulation 17/62

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states had delegated considerable authority to the High Authority under the Treaty of Paris to regulate mergers in the coal and steel sectors (Article 65 and 66). Rather, the prevailing view is that negotiators believed that merger control was either unnecessary or should remain the domain of national authorities.

On 6 February 1962, member government agreed unanimously to pass Regulation 17. The regulation set out the administrative framework for competition policy left incomplete in the Rome Treaty. Specifically, the regulation set out the procedural guidelines governing the exercise of authority under Articles 85 and 86. The regulation confirmed the principle set out the Rome Treaty that the Commission sits at the administrative center of the competition policy regime. The regulation clarifies Commission enforcement and policy-making prerogatives. Commission authorities alone were to interpret and apply the provision contained in Articles 85 and 86 including, *inter alia*, the right to authorize exemptions under Article 85(3). Moreover, when Commission authorities acted, national authorities were required to discontinue any proceedings of their own. To assist the Commission in the execution of its broad responsibilities, the regulation granted the Commission broad investigatory and enforcement powers. Finally, where it finds undertakings are in violation of their obligations under Article 85 or 86, the Commission possessed the authority to impose fines (subject to review by the Court of Justice).

The decision to delegate such an extensive grant of authority to the Commission was not popular with all member governments.<sup>17</sup> During negotiations, the Commission argued that the even and consistent application of Community law required centralization of authority within its hands. France, in particular, demurred. It opposed centralizing authority in the hands of a body it could not control. The government was concerned that the Commission might take decisions that would undermine the pursuit of national industrial policy goals. For this reason, France insisted that constraints be placed on the exercise of Commission authority. Specifically, it sought to require that DG IV obtain prior approval from of an Advisory Committee comprised of member government representatives taking a final decision (Goyder 1998:45). Doing so would provide member states the opportunity to review DG IV's reasoning and conclusions and, when circumstances dictated, veto a decision.

The French position, however, was not universally shared. German negotiators, in particular, opposed the inclusion of such a gate-keeping role for member governments. They supported the Commission position that Community functionaries should be insulated from national political influence. Only a process free from politicization could insure the uniform application of Community law.

After extended discussion a compromise was finally reached. Article 10 of the regulation required the creation of an Advisory Committee on Restrictive Practices and Monopolies of the sort recommended by the French. However, to their disappointment, the committee lacked blocking authority. DG IV officials would be required only to "consult" the committee before taking a final decision. The decision itself, however, rested in the hands of the Commission.

In retrospect, the introduction of Council Regulation 17 marks an important event in the history of merger control. However, it is not because the regulation had anything to do, in a strict sense, with mergers. It did not. Regulation 17/62 simply set down the administrative framework within which the Commission was to exercise the authority under Articles 85 and 86. Nonetheless, the

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<sup>17</sup> For an account of the negotiations from the perspective of one of the participants, see von der Groeben (1985:108-111). See also, Goyder (1998: 34-51).

passage of the regulation is significant to the unfolding story of merger control. It is so for two reasons. First, the regulation defined the manner in which the Commission would subsequently seek to exercise its authority. By filling in aspects of the delegation contract left underspecified in the Rome Treaty, the regulation clarified both the scope of Commission authority as well as the manner in which that authority was to be used. In so doing, it established set the boundaries within which the Commission would have to act. Take, for instance, the inclusion of the Advisory Committee procedure. Though not obliged to act on the position of the committee, the Commission was legally bound to carry out the consultations. This provided a mechanism whereby member governments both gathered information from, and shared views with, their agent. Active monitoring in this way served a deterrent function. Compelling the Commission to communicate its actions reduced the likelihood that its actions would go undetected. This, in turn, reduced the likelihood that the Commission would act beyond its mandate.

The second reason Regulation 17/62 is important is because the negotiations leading up to the passage were illustrative of a feature that would also be common in subsequent negotiations over merger control. It illustrated that member governments were far from united in how desirable they regarded the exercise of Commission authority. Some were far more supportive of giving Commission discretionary latitude than others. This is important, not just because it helps us understand the substance of Regulation 17/62, but because it is indicative of divisions among member states that would reappear throughout subsequent negotiations over the Commission's role in merger control.

### The 1966 Memorandum

From the earliest years of the Community, the Commission regarded the absence of merger control as a serious omission from the Community's regulatory arsenal (Allen 1996:170). Regulation 17/62 notwithstanding, merger control continued to reside outside the Community competition framework and thus beyond the Commission's jurisdictional purview. Dissatisfied with the state of affairs, Commission officials considered the various avenues available to it. The clearest expression of the Commission's effort to explore the bounds of its authority is found in a lengthy policy memo published in 1966. In its *Memorandum on the Problems of Concentration in the Common Market*, the Commission made its first clear statement of what it regarded as the place of merger control in Community competition policy.

At the heart of the memo is the Commission observation that an uncomfortable relationship existed between the drive to encourage "European" scale firms and the unique and vital contribution of small and medium-sized enterprises to Community competition and consumer welfare. The concern was that excessive concentrations of market power threatened to undermine the viability of smaller firms. The Commission argued that, therefore, it would be appropriate to use its authority to forestall the oligopolization of market structure. In staking-out this position, the Commission argued *inter alia* that there was no meaningful distinction between *existing* and *acquired* dominance.<sup>18</sup> Thus, Article 86 could, at least in principle, be employed to evaluate the competitive implications of merger activity.

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<sup>18</sup> "[I]t is immaterial whether a concentration to which a firm occupying a dominant position is a party is a result of an agreement between firms or of the acquisition of a competing firm...In so far as Article 86 can be applied, it

Though bold in its language, the memo was not followed by equally bold action – at least not initially. The Commission hesitated to advance its position forcefully. Commission authorities felt they need to find an appropriate test case (Goyder 1998:380). But that would take time.

### GEMA & Continental Can

The Commission's first attempt to apply its interpretation of Article 86 was in a case that involved GEMA (*Gesellschaft für musikalische Aufführungs-und mechanische Vervielfältigungsrechte*), a German music industry trade association. One of the organization's main functions was as a clearinghouse for copyrights. GEMA rules dictated that artists who registered their work in Germany must refrain from doing so with rights societies in other member states. Concerned that GEMA was misusing its position as a *de facto* monopoly player in the German market, a coalition of music writers, composers and publishers brought the matter to the attention of the Commission. They claimed that GEMA's rules, by restricting their right to utilize the services of authors' rights societies throughout the Community unduly constrained their economic liberty and thus should be regarded as an abuse of its dominant position.

The central legal and policy issue before the Commission was essentially definitional. It concerned the matter of how to define "abuse". Although Article 86 lists a number of activities that potentially constituted abuse, it does not provide an unambiguous set of necessary and/or sufficient requirements. Exploiting the ambiguity of the article, the Commission held that the mere possession of a dominant position should be regarded as abuse within the meaning of the article. Consistent with the position articulated in the 1966 Memo, the Commission ruled that it was not necessary to prove that the organization had actually exploited its dominant position. Rather, the association's monopoly position was *itself* sufficient to imply abuse. On these grounds, the Commission ruled that GEMA was in violation of Article 86 (OJ L 134, 20.6.71).<sup>19</sup>

The significance of the GEMA case is subtle but substantial. It demonstrated that the Commission was willing to manipulate the pliant language of the Treaty competition articles to advance its policy objectives. By interpreting Community law in this way, the Commission sought to widen its juridical reach. Although GEMA did nothing to enhance of Commission's *de jure* authority over mergers, in the sense that the case did not alter the statutory rules governing competition, it did expand the spirit of Article 86 beyond firm behaviors to include market structure. The Commission now claimed that it could, in principle, subject firms to Article 86 inquiries simply on the grounds that they possessed substantial market power, without necessarily having to show that they were exploiting their position in an anti-competitive manner.

GEMA signaled the Commission's desire to probe the limits of its authority, but it still lacked a test case explicitly involving merger activity. The wait would not be a long one. The next year

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

<sup>19</sup> In its review of the matter, the Court largely upheld the Commission's ruling (CMLR D35).

Commission officials found their case in the actions of Continental Can. Continental Can Company was a New York-based manufacturer of metal cans and other packaging materials. Through its wholly-owned Belgian subsidiary, Europemballage Corporation SA, Continental Can acquired the largest German producer of packaging materials *Schmalbach-Lubeca-Werke AG* (SLW), and in so doing, became the dominant player in the German market. Soon after completing its take-over of SLW, Continental Can sought majority control of *Thomasssen & Drijver-Verblifa NV* (TDV), the dominant producer of packaging in the Benelux countries.

Upon learning of Continental Can's plan to acquire TDV, the Commission warned management that its actions raised questions under Article 86. In a written notice, Commission officials informed company management that it regarded the company as holding dominant position in the German market and that to seek control of TDV would be an abuse of this dominant position (since TDV was a major competitor in a neighboring market). The Commission argued that, should it allow the acquisition to stand, Continental Can would shortly come to hold a dominant position in a substantial part of the Community market.

The notice went unheeded. Continental Can and Europemballage undertook the acquisition anyway. The Commission reacted by using the authority granted under Regulation 17/62 to initiate formal proceedings. In its resulting decision, the Commission held that Continental Can abused its already dominant position by seeking to acquire one of its few potential competitors in Community markets and ordered the company "end the infringement" of Article 86.<sup>20</sup> Interestingly, the Commission, in its decision, did not offer evidence that Continental Can had actually "abused" its position in the marketplace. There was, in fact, no clear evidence that consumer welfare had been damaged by Continental Can's monopolistic behavior. Rather, the case against Continental Can revolved solely around the *acquisition* of a competitor. In a logic clearly foreshadowed by the 1966 Memo and the decision in the GEMA case, the Commission reasoned that Article 86 prohibitions applied not only to company abuses *ex post facto*, but applied with equal force to the preservation *ex ante* of competitive market structures. Thus, Continental Can was guilty of abuse by attempting to strengthen its already dominant position *by means of a merger*—the effect of which would be to reduce further competition in the common market.

But the final word in this matter would not rest with the Commission. Continental Can, rather than comply with the Commission order, appealed the decision to the ECJ— an appeal that it won.<sup>21</sup> The ECJ annulled the Commission's decision and allowed the acquisition of TDV to stand.<sup>22</sup> However, even as the Court rejected the Commission's decision on the facts of the case, the judicial body upheld the general thrust of the Commission's reasoning. The Court agreed with the Commission that expansion of dominant position *was* sufficient legal grounds for the application of Article 86. Thus, the Commission *was* within its power to scrutinize mergers that threatened to create firms with a dominant position, even though the resulting firm may not evince any actual abuse. The Court linked the Commission's broad reading of Article 86 with the general competition objectives laid down in Article 3(f). In so doing, the Court seemed to

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<sup>20</sup> 1972 CMLR D11

<sup>21</sup> Notably, no member government actively opposed the Commission's decision.

<sup>22</sup> *Europemballage Corporation and Continental Can Company Inc. v. EC Commission* 1973 CMLR 199

suggest that the Commission would be within its jurisdiction to evaluate a wide range of activities of dominant firms that had as their intent or effect the undermining of competition in the common market. In the end, though the Commission lost the skirmish, it won the battle.

It is difficult to overstate the importance of the Continental Can case for the evolution of merger control. While it did not result in the de facto introduction of a Community merger control regime, nor, for that matter, did it provide a clear mandate for the Commission to exercise merger control authority, it nevertheless signaled a substantial change in prevailing interpretation of Article 86 – one of the central pillars of Community competition law. It is significant to our narrative for two additional reasons. First, it provides additional evidence of the Commission intention to push the bounds of its existing legal authority in order to advance the cause of merger control. And second, it highlights for the first time the dynamic interplay between the Commission and the Court. The Court, like the Commission, is an agent of member governments. Treaty Articles 173 and 175 (new Arts. 230 and 232) make clear that of its main functions is to act as an institutional check on the actions of other Community institutions, including the Commission. For this reason, the fate of the Commission's effort to read merger control into its existing treaty authority depended to no small degree on the decision taken by the Court. That the Court supported the Commission's interpretation of Article 86 in Continental Can, even as it rejected the Commission's actions in the case, provided crucial support for its claim. Had the Court decided differently, however, Commission efforts to apply the article in this manner would have been dealt a severe blow – and all without member government principals having to act.

### **C. 1973-1985: Two Steps Forward, One Step Back**

Prior to 1973, development in merger control involved principally questions of legal interpretation. The issue had not yet taken on a political identity. However, beginning in 1973, merger control would become politicized. The Commission, spurred in part by the halting progress in expanding its authority *de facto* through creative interpretation of Treaty articles, began a process whereby it sought to acquire greater *de jure* authority through legislative action. The first substantive effort in this regard was its 1973 draft Merger Regulation.

#### **The 1973 Draft Regulation**

In July of 1973, the Commission offered a draft proposal for a Community merger regulation to the Council.<sup>23</sup> The rationale for the proposal was outlined in the *First Report on Competition* published by the Commission the same year. In it, the Commission highlighted the fact that a sizable increase in cross-border mergers was underway.<sup>24</sup> As a consequence, the concentration of market power in some sectors increased markedly, sometimes by as much as half. In a few industries the top four largest firms controlled between 80% and 90% of sales or production

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<sup>23</sup> Proposal for a Regulation (EEC) of the Council on the Control of Concentrations between Undertakings, submitted to the Council by the Commission on 20 July 1973 (OJ C 92/1, 31.10.73).

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

(CEC 1974:31). Thus, the Commission reasoned, as merger activity continued to increase more potential competitors would be squeezed-out and consumer welfare would begin to suffer. On this basis, the Commission argued that a Merger Regulation would provide the legal tools required to ensure that Community markets remained competitive.

The proposal had three main elements. The first concerned the *scope* of merger control. In principle, *all* mergers involving Community firms would be subject to review. The Commission, however, stipulated three derogations from this requirement would obtain. First, a merger valued at less than UA (ECU) 200 million would be exempt from the approval process. Also excluded would be mergers that resulted in a firm having less than a 25% market share in any given member state. Finally, mergers in specific industrial sectors, most notably shipbuilding and motor vehicles, would be exempt provided the transaction could be shown to be “indispensable to the attainment of an objective which is given priority treatment in the common interest of the Community.”<sup>25</sup>

The second element of the proposal concerned *the criteria* used when evaluating the competitive impact of a merger. Consistent with the position articulated in *Continental Can*, mergers would be evaluated against the level of “effective competition” that was likely to prevail in Community markets in the presence of the new firm.<sup>26</sup> Firms that acquired or enhanced their power so as to hinder effective competition would be regarded as incompatible with the common market.

The third element of the proposal addressed *administration and enforcement*. Under the proposed regulation, the Commission would exercise investigative, decision-making and sanctioning powers similar to those it possessed under Regulation 17. Member governments would be only marginally involved in the process. Although the Commission would be required to consult member governments before taking action, the opinion of the committee would carry no binding force.<sup>27</sup> Where the Commission concluded that a merger would be incompatible with the common market, it would have the power to request changes in the terms of the merger or issue an outright ban. Moreover, to ensure that decisions handed down by the Commission would be heeded, the proposal contained a clause authorizing the Commission to penalize noncompliance. Firms that failed to comply with a decision to prohibit or amend a transaction were subject to fines.

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<sup>25</sup> It is interesting to note that the provisions of the proposed merger regulation reflect political sensibilities closer to those embodied in the Community’s policy against restrictive practices (Article 85) than its monopoly policy (Article 86). Like Article 85, the proposed regulation allowed for specific exemptions from the from the general prohibition of anti-competitive mergers. Indeed, as George and Joll (1975:28) note, the “grounds for exemption were wider and vaguer” than those listed in Article 85(2). They go on to suggest that this was a pragmatic move on the part of the Commission. Given the Community’s general ambivalence towards mergers in the past, the authors suggest that it would very difficult to forward a law that pushed for outright prohibitions.

<sup>26</sup> Factors to be taken into account in assessing a merger included the economic and financial power of the firms involved, market structures and the scope for choice available to suppliers and consumers.

<sup>27</sup> The member states could, however, challenge a Commission decision before the Court under Article 173(1) for violation of the Treaty or for abuse of discretionary power.

The proposal received a lukewarm reception by the Council.<sup>28</sup> It was clear early in the process that the required unanimity was not forthcoming.<sup>29</sup> Specifically, considerable differences existed among member governments on two key provisions. First, governments differed over the appropriate criteria used to evaluate proposed mergers. Specific derogations in the proposal notwithstanding, French, Italian and British authorities opposed the proposal on the grounds that it would undermine the ability of governments to pursue industrial or other social policy goals that served a broad “public interest”. They demanded changes that would explicitly integrate industrial policy considerations into the legislation’s evaluative criteria (Wullaerts et al, 1988:281).<sup>30</sup> British reluctance was amplified because they did not believe there was clear evidence that the competition effects of cross-border concentrations were of sufficient importance to require Community legislation (Bulmer 1994:429).

By contrast, Germany, Denmark, Ireland and the Benelux countries generally supported the idea of a Community-level merger control policy. The reasons for this support, however, differed. The Germans were comfortable with the Commission’s draft merger since it closely mirrored the political and economic philosophy prevailing in German competition law (Woolcock 1989). The Germans were pleased that mergers would be evaluated against pure competition criteria. They also supported the goal of a “one-stop shop” for merger control. The German government felt that its highly competitive firms—those most likely to be covered by the Regulation—would benefit from a single Community-wide approval system that supplanted multiple domestic jurisdictions. Though smaller member states followed Germany in supporting the principle of a single merger policy governed by neoliberal principles, their support is more appropriately interpreted as pro-integrationist gesture since few Irish or Benelux firms were of sufficient size to trigger a Commission review.

The second provision over which member states differed was the distribution of administrative and enforcement authority. The most controversial provision was that which would give sole decision authority to the Commission. Member state views on this set of provisions fell along lines similar to those regarding the regulation’s evaluative criteria. Germany, Denmark and the Benelux countries supported the Commission’s call for decision independence (Wullaerts et al, 1988:624). They were wary of giving member states a voice for fear that governments might manipulate the decision-making process to benefit domestic firms. The UK, France and Italy, on the other hand, opposed transferring sole authority to the Commission. France and Italy feared that the Commission might render decisions that would harm vital domestic industries. Britain

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<sup>28</sup> Consistent with Community procedure, the proposal was also considered by the European Parliament and the Economic and Social Committee (EcoSoc). For their respective opinions on the legislation, see OJ C 23, 8.3.74 and OJ C 88, 26.7.74.

<sup>29</sup> Procedurally, the proposal required unanimity in the Council because the regulation was offered under Articles 87 and 235 of the Rome Treaty. Reference to Article 235 was necessary because the powers created in the proposed Regulation extended beyond the mere “implementation of the principles laid down in Articles 85 and 86” as stipulated in Article 87.

<sup>30</sup> Britain, unlike France and Italy, had a domestic legal structure in place to govern merger control. However, British merger law did not put sole emphasis on competition as an inherently desirable objective. Unlike the Commission’s proposed law, British competition authorities had the latitude to consider whether a merger had a “public interest” dimension. While the Commission had included a diluted public interest clause in the proposal, the British did not find it strong enough to warrant ceding domestic authority.

opposed the transfer of authority on the grounds that it already possessed a domestic legal framework for the evaluation of mergers. It had little desire to transfer sovereign control lock-stock-and-barrel to the Commission.

### The 1981 Draft Regulation

In 1981, the Commission submitted a revised draft of its 1973 proposal to the Council of Ministers (OJ C 36, 12.2.82). In it, the Commission sought to address the concerns expressed by opponents of the earlier proposal. One of the major revisions included a narrowing of the regulation's scope. Mergers would fall within the jurisdiction of Community authorities only where the aggregated turnover of participant companies exceeded UA 500 million (formerly 200 million) and Community-wide market share was projected to exceed 20 percent. While the Commission narrowed the scope of the regulation, it did not to change appreciably those provisions relating to the distribution of administrative authority. In a nod to member states, such as France, that wanted greater oversight of Commission decision-making, the revised proposal included a provision that would allow governments, through the Advisory Committee, to delay Commission action. However, it resisted calls from some member states to include provisions that would allow member governments to veto or materially alter its decisions.

The proposal proved to be a non-starter. Again, member governments in the Council were unable to muster the necessary unanimity (Allen 1983). Differences fell along familiar lines. Germany and the smaller countries generally supported the general thrust of the proposal, while France, Italy and Britain opposed it. For example, Commission efforts to narrow the scope of the regulation, while favorably received, were insufficient to win over reluctant governments. Moreover, Britain and France continued to oppose provisions that would confer sole administrative authority to the Commission. They demanded that the role of the Advisory Committee be further strengthened – in order to give member governments the capacity to shape the substance of Commission decisions. Finally, France and Italy continued to express their concern over the commitment to the use of pure competition criteria. They insisted that the Commission integrate a more expansive public interest dimension (a position that the Germans and the Benelux countries avowedly resisted).

The failure of the 1981 proposal would be followed by two more proposals, one in 1984 and the other in 1986. Changes to the 1981 proposal were few, but noteworthy. The Commission, reacting to member state concerns over the scope of its authority, further modified the turnover thresholds. After first raising the worldwide turnover threshold from ECU 200 million to ECU 500 million in its 1981 draft proposal, the Commission raised it even further to ECU 750 million. However, it reversed direction in the role it foresaw for the Advisory Committee. Whereas the 1981 proposal provided member governments with a procedure to delay Commission decisions, the 1984 and 1986 proposals abandoned this language. Language similar to the 1973 proposal (and Regulation 17/62) was reinserted. The Commission agreed to the requirement that it consult member governments, but no longer thought such consultations should have any binding influence on the decisions it made.

Neither fared any better than the proposal that preceded it. The fault lines between governments were by now becoming familiar. Germany and the smaller member states generally supported the proposals. France, Italy and the UK continued to resist. Prospects of giving merger control a community dimension seem as remote as ever. This would soon change.

### The Single European Act

The renewed interest in merger control would emerge, at least in part, in the way of the ratification of the Single European Act (SEA). Although the SEA did not directly address the question of merger policy, the Commission's 1985 White Paper argued that strengthened antitrust enforcement - include a robust policy towards mergers - was a necessary concomitant to liberalization. Commission officials reckoned that nearly half of the economic benefits of single market project would be realized through industrial restructuring, the likely result of which would be a massive upsurge in trans-European mergers, acquisitions and joint ventures. The anticipated rise in the scale of business raised concern that the resulting market consolidations would result in some transactions whose effect would be decidedly anticompetitive.

There was also widespread recognition that market liberalization and the Europeanization of industry promised to raise thorny jurisdictional questions. Firms wishing to exploit the opportunities presented by the single market might find their behavior encouraged by in one country while simultaneously prohibited in another. Governments who hitherto resisted calls for a Community-wide merger regime had to confront the fact that it would be clearly contradictory to the principle of free market to have widely different systems of merger control.

### **D. 1985-1989: The Endgame**

Against this background of economic change, Commission competition authorities saw an opportunity to yet again press their case for some sort of Community-level merger control. In a speech to national Ministers of Competition then-Competition Commission Peter Sutherland emphasized the need to move forward,

Let me now address a major issue which is a pre-occupation of the Commission and will become even more so in the coming months: the old but nevertheless currently increasingly important question of a European system of merger control and authorization. This is not merely a question concerning traditional competition policy; *a Community-wide merger regulation is now a vital instrument in achieving a single integrated market by 1992* (emphasis added).<sup>31</sup>

His comments reflected the urgency with which officials in DG IV regarded the matter. Commissioner Sutherland sought to make it clear that the status quo was no longer tenable. Legislative progress on a merger regulation had become imperative. Moreover, so long as member governments resisted concerted action on this front, the Commission would continue to push the interpretation of competition articles to develop *de facto* what governments were resistant to provide *de jure* (Goyder 1993:391). Significantly, in a departure from past thinking,

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<sup>31</sup> Speech given in July 1987 as quoted in Wullaerts, et al (1988:289).

Sutherland and others in the Commission started to make the argument that Article 85 might be used as a legal basis for monitoring acquisitions under certain limited conditions.

Sutherland also used his public statements as a vehicle to communicate a new direction in the Commission's legislative strategy. On more than one occasion Sutherland stated that he would look for a Treaty basis for legislation that would not be held hostage to one or two reluctant members. He suggested, for instance, that Article 87 might be sufficient as a legal basis for a regulation.<sup>32</sup> What his predecessors could not accomplish by unanimity, he would seek to secure by qualified majority.

### Philip Morris

In 1987, Commission efforts received a dramatic and unexpected boost. In November of that year, the ECJ handed down a ruling on a long-simmering row in the tobacco sector between the Commission and Philip Morris. As issue in the case was whether Philip Morris' proposed acquisition of Rothmans Tobacco would result in a distortion of competition in violation of Article 85(1). Two of Philip Morris' chief rivals, RJ Reynolds and British American Tobacco (BAT), weighed in on the matter. RJ Reynolds and BAT claimed that to allow Philip Morris a controlling interest in Rothmans would, in effect, allow it to influence conditions in the European tobacco market. The resulting distortion of competition would clearly violate enumerated prohibitions in Article 85(1) without contributing positively to either production/distribution or technological progress, thereby it would fail to qualify for exemption from prohibition under Article 85(3). After consulting with the Commission about these concerns, Philip Morris offered to amend the deal. Satisfied with the changes, the Commission granted Philip Morris an exemption under Article 85(3).

However, as soon as the Commission decided to grant the exemption, RJ Reynolds and BAT lodged a complaint with the ECJ under Article 173 (Art. 230) to have the exemption overturned. The firms pushed their claim that the acquisition would allow Philip Morris powerful leverage of Rothmans, notwithstanding emendations to the deal. They argued that Philip Morris might, among other things, use its privileged position to seek control of Rothmans in the future, thereby accomplishing by stealth what it could not secure overtly.

The Court, unconvinced by the argument presented by RJ Reynolds/BAT, ruled in favor of the Commission/Philip Morris.<sup>33</sup> However, in a ruling whose importance to the story of merger control is rivaled only by that issued in the Continental Can case, the Court argued that while acquisitions of equity interest did not constitute *prima facie* evidence of anticompetitive behavior, such acquisitions *might nonetheless serve as an instrument to that end*. By stressing a

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<sup>32</sup> Stated Sutherland, "If there is no prospect of progress the Commission must envisage alternative means of achieving Community-wide merger control. There are a number of options available. One is a regulation based on Article 87 concerning the applications of Articles 85 and 86 to mergers which would only require a qualified majority in the Council" (Wullaerts et al, 1988:286).

<sup>33</sup> This case is alternately described as the Philip Morris case or the RJ Reynolds/BAT case. The Commission and most commentators refer to it as Philip Morris. However, one might find that it is referred to as RJ Reynolds/BAT; the reason being that the Court decision settling the case was initiated by these actors (*BAT and RJ Reynolds v. Commission* [1988]).

test of “legal or de facto control” and reaffirming the Commission’s authority to evaluate transactions falling within the ambit of Article 85, the Court came extremely close to declaring that Article 85 could in fact be used to evaluate mergers and acquisitions (Wullaerts et al, 1988:274). The upshot of the decision was that the Commission no longer was forced to prove “dominance” – as it had to in order to employ Article 86 prohibitions – it had only to show that a takeover might be carried out with the intention of reducing effective competition. In so arguing, the Court intimated for the first time that Article 85, long held by the Commission to be a legally questionable basis for merger control, might in fact be used for just that purpose.

The impact of the *Philip Morris* case was immediate and significant. In early 1988, the Commission demanded and won changes in two high profile mergers: the takeover of British Caledonia by British Airways, and the acquisition of Irish Distillers Group (IDG) by a consortium of British beverage producers.<sup>34</sup> The legal ramifications of Philip Morris confirmed the worst fears of some member governments: the Commission was securing *de facto*, what they had been unwilling (or unable) to delegate *de jure*. Not only was the Commission’s legal authority growing, but it was doing so without clearly defined limits. If member governments were to retain any voice over the direction of merger control, they would have to act by passing a regulation to govern merger control

The *Philip Morris* decision changed the politics of merger control considerably. Business interests across the Community increasingly coalesced behind the idea of a single merger regime (Woolcock 1989, Bulmer 1994).<sup>35</sup> Industry dissatisfaction with the status quo was summarized by Heinz Kroger, head of company affairs to the federation of European employers (UNICE), “We have the worst of all worlds at the moment—narrow national controls supplemented by a Community control where nobody knows which criteria apply. The sooner we get the regulation the better” (*Financial Times*, 20 December 1988:20). Industry desired a degree of legal certainty and procedural predictability and they began to apply increasing pressure on governments to provide it.

Gradually, member states, even those wary of Commission activism, began to acknowledge that the prevailing state of affairs was untenable. The same procedural uncertainties that concerned business interests influenced the thinking of member governments. As Goyder notes, “Possibly...the most important outcome of the case from the Commission’s viewpoint was its likely effect in concentrating the minds of the more unwilling Member States, fearful of the use of the *Philip Morris* precedent to attack mergers under Article 85” (1993:392). A regulation specifically addressing merger activity would allow governments to reassert control over the course of events. With it, they could clarify jurisdictional questions and substantive standards.

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<sup>34</sup> In the British Airways case, the Commission won changes in the terms of the merger; this despite the fact that British competition authorities had already approved the deal. In the Irish Distillers case, the Commission forbade the acquisition of IDG by a holding company formed by Allied-Lyons, Guinness and Grand Metropolitan on the grounds that the consortium had been formed specifically to prevent more competitive bids and that the acquisition, were it allowed to proceed, would increase the acquiring firms’ already dominant position. For summary details of both cases, see the *18th Report on Competition Policy*.

<sup>35</sup> Bulmer (1994:432) suggests that the uncertainty created the Commission activity contributed to the creation of an “unstoppable alliance” of Commission officials, industry actors and the Court. While this perhaps overstates the case, Bulmer is correct to highlight the degree of preference consonance among these actors.

Without it, uncertainty would prevail as Commission authorities would have the power to address mergers without any statutory guidance as to how it should be used. Allen adroitly summarized the state of affairs, “By a combination of luck and skill the Commission had managed to create a problem which the Council felt it could be eased only by passing the legislation it had previously refused to (seriously) consider” (1996:171).

### The 1988 Draft Regulation

Five months after the Philip Morris judgment, the Commission submitted a new draft merger regulation to the Council.<sup>36</sup> The proposal embodied some notable changes from earlier efforts. One regarded the scope of Commission control. In an apparent concession to reticent member states, the new draft held that mergers would be considered exempt *unless they exceeded* some minimum threshold. In departure from the ethos of the earlier proposals, where all mergers were to be subject to Community control *unless they fell below* a certain threshold, only those mergers meeting the threshold conditions were subject to review. What is more, the Commission raised the threshold from ECU 750 million (which had been included in the 1986 proposal) to ECU 1 billion – fully five times higher than the value stipulated in the 1973 proposal.<sup>37</sup> Moreover, mergers, whatever their size, were excluded from review if more than 75% of the aggregate EC-wide annual turnover occurred in a single member state. Finally, the proposal exempted mergers whose aggregate EC market share would be less than 20 percent. The effect of the changes was to further narrow the Commission’s scope of authority. But it did so not by reducing the authority it could exercise but to narrow the range of circumstances in which it could exercise it.

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

The second issue was the criteria used to evaluate covered mergers. In the proposal, the Commission provided a public interest derogation from the pure competition criteria in the

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<sup>36</sup> OJ C 130, 19.5.88. Actually, between the 1981 proposal and the one offered in 1988, the Commission floated two slightly amended versions of a merger regulation past the Council: one in 1984 and a second in 1986. Because the changes offered in these proposals were quite minor, neither represented enough of an advance on the 1981 effort to warrant any shift in support within the Council. Consequently, they were both dead on arrival. For the text of the amended proposals, see OJ C 51, 23.2.84, and OJ C 324, 17.12.86.

<sup>37</sup> According to the draft, mergers involving a firm whose worldwide turnover exceeded ECU 1 billion might nonetheless be exempt if the firm being targeted has less than ECU 50 million in worldwide turnover.

“dominant position” test. This would compel the Commission to consider industrial, regional and social policy concerns when assessing mergers. France and Italy had long insisted that such a provision be included. After accession they were joined by Portugal and Spain. However, Germany now joined by Britain, regarded the notion of diluting competition rules in this way as anathema. They opposed the inclusion of such a provision out of the fear that the Commission to use it as a tool to pursue an activist industrial policy (Woolcock et al 1991:17).

Finally, member governments continued to differ over the appropriate locus of administrative control. While the Germans and the French desired to centralized control in the Commission (albeit for different reasons), the British resisted adamantly. The Germans felt it was imperative to establish a single administrative entity beyond the political control of national governments. For their part, the British government, deeply distrustful of what it perceived as Brussels’ industrial policy bent, lobbied hard for decentralized control where national competition authorities would remain dominant. The smaller member states, for their part, supported centralized control. Growing economic interdependence coupled with the absence (in most cases) of effective domestic merger control regimes inclined smaller countries to favor more, not less, Commission control (Bulmer 1994, Schwartz 1993:651).

#### 1988-89: An Agreement At Last

Negotiations progressed slowly. Responding to a commitment by the British and Germans to end their objections if thresholds were raised, the Commission once again amended its proposal. In an informal proposal communicated through a public statement, the Commission agreed to raise the worldwide turnover threshold ECU 1 billion to ECU 5 billion.<sup>38</sup> In addition to changes in the thresholds, the Commission further stipulated that merger entities that generated two-thirds of the EC-turnover (down from three-quarters) in a single member state would also be exempt from review (*Financial Times*, 1 April 1989:1). Although the Germans and British expressed satisfaction with the higher thresholds, and were favorably inclined toward the proposal, now it was the turn of smaller countries to object. They issued their own call for revised thresholds. They demanded that the worldwide threshold to be lowered to ECU 2 billion. Furthermore, the French and Italians, dissatisfied with the ambiguous language of the public interest clause, continued to insist that industrial policy criteria be considered as a factor in merger decisions. In June 1989, it looked once again as though an agreement would remain beyond reach.

The crucial breakthrough came late in 1989. In July of that year, France assumed the Council Presidency. Among its stated policy objectives was the finalization of merger negotiations. Edith Cresson, France’s European Affairs Minister, announced that Paris wanted a merger regulation by Christmas (*Financial Times*, 18 July 1989:2). As a gesture of good will to Britain and Germany, the French government softened its call for an industrial policy clause in the competition criteria (*Financial Times*, 12 October 1989:2). In return, Germany and Britain agreed to accept thresholds lower than they had originally demanded. The Merger Regulation contained thresholds of ECU 250 million for Community turnover and an aggregate worldwide

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<sup>38</sup> The figure of ECU 5 billion was achieved only after much discussion. Previously, the UK and Germany had demanded an even higher threshold of ECU 10 billion (Woolcock 1989).

turnover of ECU 5 billion.<sup>39</sup> However, in a concession designed to win the support of the smaller states, they agreed that these thresholds were subject to review in five years time and that adjustments thereto would require only a qualified majority vote in the Council. The parties also reached an accommodation on the standard against which mergers would be evaluated. Responding to French demands, the Regulation would include a modified version of the public interest clause. However, the criteria contained therein would be in line with the preferences of the more neoliberal-minded member states.

Finally, elements of a political compromise are also found in the administrative framework embedded in the regulation. To mollify concerns that authority granted to the Commission was too extensive – this, even though the scope of Commission authority had been significantly pared back by ever higher thresholds – the German government insisted that a provision be included in the regulation that would allow member governments to petition the Commission for the authority to conduct its own investigation where a prospective merger has substantial effects on a market *within* a member state. This provision would come to be known as the “German Clause.” Interestingly, the compromise also included a provision that can be seen as the obverse of the German Clause. This provision, supported by many small states, allows member states to invite the Commission to investigate mergers falling below agreed upon thresholds. This concern, voiced most ardently by the Dutch, was that many states lacked either effective national laws or the resources sufficient to deal with a merger that would have a significant impact on the domestic economy. The “Dutch Clause,” as it would become known, gave states the ability to draw on Commission expertise even though the concentration would not otherwise fall under its jurisdiction.

## V. CONCLUSION

Simon Bulmer (1994), in his highly regarded and oft-cited study of the history of merger control, argues that to understand the 1989 Merger Regulation one must examine the institutional context in which policies are crafted and implemented. Two Community institutions – the Council and the Court – are singled out for their contribution to the unfolding merger control story. Specifically, Bulmer argues that the 1989 Merger Regulation is a negotiated policy to critical changes in the political environment wrought by a) increased pressure of business groups in the wake of the single market project and b) the growing clutch of ECJ decisions on legal questions related to merger activity. But it is the member governments, and the process of intergovernmental negotiation, that does the analytical heavy lifting. McGowan and Cini (1999) advance a similar argument, suggesting that efforts to pass merger control legislation in the 1970s and 1980s failed because those proposals “failed to find favor with the Council” (1999:179). Schwartz (1993) advances this position even more forcefully, viewing the history of merger control through the lens of “politics as usual.” In these observations, the authors are absolutely correct. Where unanimity rules apply, intergovernmental agreement is *sine qua non* if legislative progress is to be made.

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<sup>39</sup> These are compared to the Community and worldwide turnovers of ECU 100 million and ECU 1 billion (respectively) stipulated in the 1988 draft. The final legislation also included a provision exempting mergers where >2/3 of EC turnover is in one state (compared to >75% in the 1988 proposal).

But such accounts tell only part of the story (albeit an important part). What these studies generally lack is an analytical framework within which to understand either *why* events unfolded as they did and *how* they shaped the content of the MR itself. In this regard, I have argued that insights borrowed from Agency Theory may prove helpful. This is because agency theory draws our attention to the dynamics of authority relations – to the relationship between those who possess political authority (Principals) and those to whom they delegate some measure of that authority (Agents). It thus provides a framework with which to understand not just the nature of interactions amongst those actors at the center of merger control story – the member states, the Commission and the Court of Justice – but how those interactions shaped the substantive content of the MR itself.

I have suggested, for instance, that Commission efforts to craft for itself a measure of merger control authority from Articles 85 and 86 provided the key impetus propelling events. Though it is not clear whether merger control policy would have taken on a Community dimension without the actions of the Commission, it would certainly have taken on a different form had the Commission elected to pursue a different course than it did. Beginning with the 1966 Memorandum and continuing through its actions, legal and legislative, the Commission sought to shape merger control. Explanations that fail to adequately account for Commission actions in this regard miss an important explanatory element.

Though an understanding of Commission action is clearly a *necessary* component of a full understanding of the origins of merger control, it is far from *sufficient*. The Commission's actions only take meaning through the manner in which they influenced other key policy actors. And it is here that the dynamics of delegated authority come into high relief. For instance, the persistent resistance of some member governments to giving merger control a community dimension did not arise from an absolute opposition to the idea of merger control per se. Rather, it only makes sense when this opposition is understood in the context of jurisdictional questions such as who will exercise authority, over which mergers, and under what conditions. True, as the literature informs us, the persistence failure of proposal after proposal was the result of intergovernmental disagreement. But when one looks at the substance over which member states disagreed, it was not about the desirability of merger control per se, as much as it was over the specific rules to be applied and the role the Commission would play in administering them. Or, in the language of agency theory, it was disagreement among political principals (member states) over what authority should be delegated to their agent (the Commission) and what constraints should be placed on the exercise of that authority.

It is important to emphasize, at this point, that Agency theory does not purport to explain everything. As a middle range theory, it claims only to speak to a particular aspect of the empirical world – in this case the authority relationship between principals and agents. It is not, therefore, equipped to explain aspects of merger control that fall outside that dynamic. It cannot, for instance, account for the source of actor interests. It tells us nothing about why France demanded merger control rules that contained public interest considerations or why Germany demanded criteria reflecting pure competition concerns. It does, however, provide insight into how these actors pursued their interest in an institutional environment where authority for executing the rule would fall to an agent.

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