FACULTY OF LAW
University of Lund

Anna Eklöf

In the aftermath of the EC merger control reform -The relevance of efficiencies in merger assessments

Master Thesis
30 ECTS credits

Henrik Norinder

EC Competition Law

Fall 2005

Contents

SUMMARY 1

PREFACE 3

ABBREVIATIONS 4

1 INTRODUCTION 5

1.1 Purpose 5

1.2 Method and material 6

1.3 Delimitations 6

1.4 Disposition 7

2 INTRODUCTION TO CONCENTRATIONS UNDER EC MERGER CONTROL 8

2.1 Policy reasons for merger control 8
2.1.1 Some underlying rationals for firms to merge 9
2.1.2 Reasons for merger control 10

2.2 Concept of concentration 11

2.3 Community dimension 12

3 INTRODUCTION AND PRINCIPLES OF EFFICIENCIES 14

3.1 Empirical evidence 15

4 THE NEW SUBSTANTIVE TEST UNDER THE MERGER REGULATION 17

4.1 The Dominance test under the Old Merger Regulation 17
4.1.1.1 Scope and assessment 18
4.1.1.2 Decisional practice of the Commission relating to efficiencies under Old Merger Regulation 19
4.1.1.3 Concerns about the old dominance test 23

4.2 The SIEC test- an improvement or impediment? 23
4.2.1 Scope and assessment 25
4.2.2 The “European solution” 25
4.2.3 Possible effects due to the reform 26

4.3 The Horizontal Merger Guidelines 28
4.3.1 Non-coordinated effects 29

4.3.2 Coordinated effects 30

5 EFFICIENCIES UNDER CURRENT EC MERGER CONTROL 31

5.1 Legal framework 31
5.1.1 Benefit to consumers 32
5.1.2 Merger specificity 34
5.1.3 Verifiability 35
5.1.3.1 Burden of proof 35
5.1.4 Case law versus Horizotal Merger Guidelines 36

5.2 Efficiency effects of non-horizontal mergers 38
5.2.1 Example of decisional practice relating to efficiency effects of non-horizontal mergers 39

5.3 Efficiencies- a defence or a factor in the overall assessment of the operation? 40
5.3.1 European approach 41

6 FINAL REMARKS 45

BIBLIOGRAPHY 47

TABLE OF CASES 51

Summary

One of the most common reasons for a firm to merge is that a merger is believed to generate economic efficiency. This argument has different aspects as mergers may yield efficiency gains in various ways.

Economists often distinguish between three different classes of efficiencies: Allocative efficiency, productive efficiency and dynamic efficiency. All three classes are relevant in the analysis of the impact of a concentration on effective competition.

Allocative efficiency refers to the optimal situation when products are allocated between consumers according to the price the consumers are willing to pay and prices never exceed marginal cost. *Productive efficiency* is achieved when goods and services are produced to lowest possible cost and output is maximized by using the most effective combination of input. The concept (in antitrust economics) of *Dynamic efficiency* is connected with whether there is enough incentive and ability to innovate and increase productivity over time.

The approach to efficiencies under EC Merger Regulation has always been controversial. Although Article 2(1) of the Old Merger Regulation states that technical as well as economic progress has to be taken into account in the merger assessment provided that it is to the consumers' advantage and does not form an obstacle to competition, efficiencies were given little weight in merger assessments prior to the reform of EC merger control.

Nevertheless, there is evidence that the Commission actually evaluated efficiencies in some cases but the final outcomes of these evaluations were contradicting creating confusion in this area of law. In most of these cases the Commission recognized efficiencies as a pro-competitive effect generated by the merger but there are cases where efficiencies were seen as a penalizing factor. The later approach must be seen as the result of confusion regarding the interpretation of Article 2 of the Old Merger Regulation and ambiguous statements from the Commission.

The proposal of the New Merger Regulation is the result of a long period of review and in January 2004 the New Merger Regulation came into force introducing the SIEC-test as a substantive criterion. The new substantive criterion has a more economic based approach compared to the dominance test used in the Old Merger Regulation and focuses more on the effects of effective competition instead of the structure of the market. The criticism, the debate and the change of the substantive criterion in the Merger Regulation finally made it possible to explicitly introduce efficiencies to EC merger control. Today efficiencies are mentioned in both Recital 29 of the New Merger Regulation and in the Horizontal Merger Guidelines.

In order to assess whether or not a concentration significantly impedes effective competition the Commission performs an overall competitive appraisal of the merger taking into account any substantiated efficiency claims. The Commission may find, as a consequence of the efficiencies that the merger brings about, that the concentration is compatible with the common market.

A plausible approach to efficiencies in the merger review is a two-step test within the overall assessment of the operation. The first step is to evaluate the anti-competitive effects created by the merger and the second step is to evaluate generated efficiencies that counteract the anti-competitive effects. All factors are to be considered before the Commission decides whether or not the transaction significantly impedes competition. In order for the Commission to be able to clear a merger the final outcome of the merger must not make the consumers worse of than before the merger.

As efficiencies should be an integral part of the competitive effectsanalysis it is not appropriate to talk about an efficiency "defence" in the sense that they would be able to intervene after an impediment of effective competition had been found. For this reason efficiencies can not make a transaction which impedes competition compatible with the common market.

For the Commission to take account of efficiencies in its merger assessment and to be able to reach the conclusion that, as a consequence of the efficiencies the merger shall not be prohibited, the efficiencies have to fulfil three cumulative requirements. They have to benefit consumers, be merger specific and be verifiable. Moreover, since there exist an asymmetry between the competition authorities and the merging firms with regards to the information on the merger and the expected efficiencies it is up to the merging firms to provide the relative information demonstrating that the efficiency gains are fulfilling these requirements.

The long debate about the change of the substantive criterion together with the explicit introduction of efficiencies into the recitals of the New Merger Regulation and into the Horizontal Merger Guidelines indicate that efficiencies have been given a stronger position, compared to prior to the reform, in the assessment on a merger's compatibility with the common market.

Preface

The European market is constantly expanding and new rules need to be adopted. The reform of the European merger control and the explicit introduction of efficiencies in the Merger Regulation is a response to a long evolution process finally forcing the Commission to change the law. Today the earlier confusion in this area of law has been reduced, nonetheless ambiguities still remain and it is not until the Commission decides to make a thorough evaluation of efficiencies that the situation may be considered completely satisfying.

Not really realizing what a complex and challenging topic I had chosen halfway through this thesis I was ready to give up, troubled by the many different economic aspects I had to combat and frustrated over lack of relevant information. Nevertheless, somewhere in between the Swedish November storms, I found inspiration through loving friends and family to complete this thesis.

1 December 2005/ Stockholm, Sweden

Anna Eklöf

Abbreviations

the Commission	the European Commission
EC	the European Community
ECJ	the European Court of Justice
E.C.L.R.	European Competition Law Review
(New) Merger Regulation	Council Regulation (EC) No. 139/2004
Old Merger Regulation	Council Regulation (EEC) No. 4064/89
R&D	Research and Development
CMR. Rev.	Common Market Law Review
the Treaty	the Treaty of Rome as amended by the Treaty of Amsterdam

1 Introduction

It is important to be aware that mergers may not only be motivated by efficiencies and cost savings, but also by increased market shares two interests that might not always go had in hand with each other. This is an issue that the Commission deals with on a daily basis in its attempt to achieve a prosperous European economy.

The introduction of efficiencies under the EC Merger Regulation was for long a time a controversial subject, resulting in an extensive debate among practitioners and scholars. Nevertheless, in May 2004 the New Merger Regulation was implemented, replacing the Old Merger Regulation and finally explicitly introducing efficiencies to in EC merger control.

The introduction of efficiencies in the Merger Regulation is an improvement for this area of law as it provides guidance how efficiencies should be treated under the EC merger control. However uncertainties still exist and there are questions that need to be clarified; how much weight will the Commission give to efficiencies in their assessment of concentrations? Will there be some kind of hierarchy among different types of efficiencies? What level of proof is to be imposed on merging parties, and what is the relationship between old precedents in this regard and the New Merger Regulation? These are only few questions that I intend to answer in this thesis.

1.1 Purpose

The aim of this thesis is to evaluate the relevance of efficiencies under the EC Merger Regulation. In particular it aims to assess whether or not efficiencies is assessed a factor in the overall merger assessment or if Europe is moving towards an efficiency "defence". Furthermore the thesis aims to describe the change of the substantive criterion in the Merger Regulation in pursuance to assess whether or not efficiencies have been given a stronger position in the merger assessment than prior to the reform of EC merger control.

1.2 Method and material

In pursuing the goal to evaluate the relevance of efficiencies under the Merger Regulation and to assess whether or not efficiencies is assessed as a factor in the overall merger review or as a defence I have used traditional legal method. The material I have used is both the Old and the New Merger Regulation and the case law relevant to efficiencies. I have also used Commission notices and guidelines. In order to find the relevant case law I have used different articles and databases such as EC Competition Law, West Law International and ECLAS. DG Competition's web page, literature and references within Commission's notices and guidelines have also been used.

Regarding the purpose to describe the change of the substantive criterion under EC merger control and to assess whether or not efficiencies have been given a stronger position in the merger assessment after the reform of EC merger control I have used traditional legal method as described above but also a descriptive method. I have compared the approach by the Commission prior to the reform with the approach alleged to be hold today. For this purpose I have mainly used articles from the above mentioned databases.

1.3 Delimitations

In pursuing the goal to evaluate the relevance of efficiencies under the Merger Regulation I found it important to give a cohesive understanding of the history behind the change of the substantive criterion. However, many of the aspects I have brought up in this regard could be topics for an essay in there own right. Therefore I have limit myself and only touched on these aspects briefly. Some areas have been excluded entirely.

Trying to describe the substantive criterion in the Merger Regulation in pursuance to assess whether or not efficiencies have been given a stronger position in the merger assessment than prior to the EC merger control reform the thesis is likely to touch many aspects such as; calculation of turnover threshold, the assessment of community dimension, the assessment of market power, relative factors for determining market structure and issues with the dominance test. Also aspects of the Horizontal Merger Guidelines such as coordinated and non-coordinate effects, buying power, barriers to entry and failing firms.

Nevertheless, as the thesis aims to make a legal assessment of the relevance of efficiencies under EC merger control and not to describe the assessment of mergers in general, many of these aspects are excluded entirely or only covered to a limited extent. I have also chosen to almost completely exclude the comparative aspects of this field of law.

1.4 Disposition

Chapter 2 provides, in order to bring forward an understanding of the EC Merger Regulations, a description of mergers and furthermore discusses issues that merger control involves.

The chapter starts to describe horizontal and non-horizontal mergers. It further describes some of the underlying rationales for firms to merge. Furthermore the chapter provides some of the reasons why the Commission controls concentrations. Finally the chapter gives a short description of concentrations caught by the Merger Regulation.

Chapter 3 presents a discussion about the theory necessary to give a coherent understanding of the role and importance of efficiencies in merger assessments. The chapter starts to describe three different classes of efficiencies then continues with a discussion about empirical studies made on efficiency gains of mergers.

Chapter 4 provides, in order to give the historical background of the evaluation of the efficiencies, a short summary of the development of the law leading up to the change of the substantive criterion used in merger reviews. The chapter describes how mergers were dealt with by the Commission under the dominance test used under the Old Merger Regulation and in particular it provides an analysis of precedents where the Commission has evaluated efficiencies prior to the merger control reform.

Chapter 5 is the main core of the thesis. The chapter provides a description and an analysis of the legal framework regulating efficiencies under the EC merger control today. It, further, compares the legal framework with the precedents under Old Merger Regulation and evaluates their correspondence, comparing the weight given to efficiencies under the Old and New Merger Regulation.

The chapter, further, describes and evaluates the differences in the treatment of efficiencies generated by non- horizontal mergers and horizontal merger. At last the chapter aims to clarify whether efficiencies shall be assessed as a factor in the merger review or if it can be used as an efficiency defence.

Chapter 6 hold some final remarks made in regards to this study.

2 Introduction to concentrations under EC merger control

In order to give a complete understanding of the EC Merger Regulation this chapter provides a description of mergers and discusses issues that merger control involves.

The chapter starts to describe horizontal and non-horizontal mergers. It further describes some of the underlying rationales for firms to merge. Furthermore the chapter provides some of the reasons why the Commission controls concentrations and finally the chapter gives a short description of the concentrations caught by the Merger Regulation.

2.1 Policy reasons for merger control

Horizontal mergers are mergers between undertakings which make the same products and operate at the same level of the market. These mergers are considered to be most dangerous to competition as they remove direct competitive constraints in the market[1]. An example of a horizontal merger is the merger between Procter & Gamble and Schickedanz[2], where Procter and Gambler manufactured sanitary towels and Schickedanz produced tampons.

Nevertheless, even though a horizontal merger may result in the removal of direct competitive constrains, resulting in increased prices, a horizontal merger may also create efficiencies counterbalancing these effects so that the price may fall below pre- merger again[3]. This will be discussed further below.

Non- horizontal mergers take place between firms that do not operate in the same markets. These includes vertical mergers and conglomerate mergers. *Vertical mergers* are merges between companies which operate at different distributive levels of the market but in the same product market e.g. a manufacturer merging with its input supplier. An example of a vertical merger is the merger between Tetra Laval and Sidel[4]. *Conglomerate mergers,* on the other hand, are mergers between firms which have no

[1] Bishop, S, Lofaro, A, Rosati, F, Young, J; RBB Economics report, "The Efficiency-Enhancing Effects of Non- Horizontal Mergers", (2005) p. i
[2] *Procter & Gambler/ Schickedanz* (Case IV/M .430), 21 June 1994
[3] RBB Economics *op. cit. p.i*
[4] *Tetra Laval/Sidel* (Case COMP//M 2416), 30 October 2001

connection with each other in any product market[5]. An example of these kinds of mergers would be the Virgin group whose markets includes aeroplanes, train service, financial products, records stores and so forth.

In contrast to horizontal mergers, non-horizontal mergers do not remove direct competitive constrains as they only bring together suppliers of complementary or related products. Instead these kinds of mergers generally give incentives to the merged firms to lower their prices since in a complementary relationship a decrease in the price of a product may increase the sales of another product. For example a reduction in the price of a computer may increase the sales of complementing keyboards.

2.1.1 Some underlying rationals for firms to merge

The completion of the internal market and the challenges of a more integrated common market result in reorganizations of corporations, especially in the form of concentrations. The Commission welcomes such corporate reorganisations, however, only as long as the concentrations are in line with the requirement of a dynamic competition and capable of increasing the competitiveness in the European market[6].

There are numbers of ways in which mergers may be beneficial. One of the most common reason for firms to merge is that the new entity may create economic efficiency. This argument has different aspects as mergers may yield efficiency gains in various ways.

These are a few types of efficiencies that might be created from mergers:

Rationalisation of production refers to the cost savings that might be realised from shifting output from one plant to another plant without changing the firms' joint production costs[7]. Merging firms might differ in their marginal cost of production. After the merger, cost savings may be realised through shifting production from the plant with higher marginal cost to the plant with lower marginal cost.

Economies of scale refers to when a firm's average cost falls as output increases. This is a commonly used argument for a merge. However it is important to understand the source of the economies of scale and assess whether or not they cannot be realised in another way than through the merger. Economies of scale may be divided into short-run economies of scale and long-run economies of scale[8].

---

[5] P.Craig, G De Búrca, *EU Law Text Cases and materials*, (Oxford University Press, 3rd ed, 2003) p. 1034
[6] Merger Regulation No 139/2004, Recital (4)
[7] European Commission Directorate-General for Economic and Financial Affairs, European Economy reports and studies, "The efficiency Defence and the European System of Merger Control" (2001), No 5, p. 43
[8] *Ibid*., p.43

Technological progress may stem from the diffusion of know-how or increased incentives for research and development. Technological progress can be said to be generated by process innovations, which reduce the cost of producing a product and product innovations, which increase the value of a product[9].

Purchasing economies; for instance, small firms often need to purchase their input at a higher price than the marginal cost. A merger between two small firms may increase their bargaining power and more pressure can be put on their input suppliers enabling the merging firms to purchase their input at lower prices and thus reduce their costs[10].

Slack; the threat of hostile takeovers may function as a disciplining device to the management of a firm. Many firms suffer from a separation of ownership and control. This, among other things, may result in internal inefficiencies. Internal inefficiencies may lower the firm's stock price, inducing other firms to buy the firm which might not be desirable for the management of the firm.

2.1.2 Reasons for merger control

To ensure that such reorganisations of cooperation do not cause lasting damage to competition it is important to regulate concentrations that will significantly impede effective competition in the common market or in a substantial part of it[11].

The main anti-competitive concern with mergers is their potential to reduce competition. A horizontal merger may enable the merged firms to act in the same manner as a single firm in a dominate position. The most well known consequence of reduced competition is increased prices. For instance if a producer increases the prices on ice-cream the consumers might switch to another of sort of ice-cream, produced by a rival firm. Hence the producer will loose buyers and must reduce its prices again. If the two ice- cream companies, on the other hand merge, competition on the relevant market would be reduced enabling the firms to increase prices to the detriment of consumers.

Reduced competition may also result in inefficiencies and furthermore reduction in firm's incentive to produce diversified products and to innovate[12]. Hence reduced competition in the common market may adversely affect consumer's welfare.

---

[9] European Commission Directorate-General for Economic and Financial Affairs, *op.cit*. p. 45.

[10] *Ibid*., p. 46

[11] Council Regulation (EC) No 139/2004., Recital. (5)

[12] European Commission Directorate-General for Economic and Financial Affairs, *op.cit*. p. 49

The impact of vertical mergers is more debated than the impact of horizontal mergers. Although the effect of vertical merger in general is pro-competitive the price reduction brought about by the merger may under certain circumstances result in a negative effect on competition. This is because the merged firms might through, for instance, refusal to supply, force competitors to leave the relevant market enabling the merged firms to increase prices to the detriment of consumers[13].

Also the impact on the competition of conglomerate merger is disputed. Some argue that they have a negative effect on competition since they allow, for example, a wealthy firm to cross-subsidize from one product to another in order to defeat new entrants. Others are more cautious about this approach[14].

Another reason to try to regulate mergers may be regional policy. A merger may lead to the rationalisation of existing plants and this may negatively affect the region in the sense that it can cause unemployment and affect the region's vitality.

2.2 Concept of concentration

According to the Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings the concept of a concentration covers operations bringing about a change of control on a lasting basis resulting from:

a) the merger of two or more previously independent undertakings
or parts of undertakings, or

b) the acquisition, by one or more persons already controlling
at least one undertaking, or by one or more undertakings,
whether by purchase of securities or assets, by contract or
by any other means, of direct or indirect control of the
whole or parts of one or more other undertakings.[15].

In other words; a concentration is formed either by a merger between two previously independent firms or by the acquisition of control of the whole or parts of another firm. In order to determine the existence of a concentration the Commission uses a qualitative criteria rather than a quantitative criterion[16].

---

[13] RBB Economics *op. cit.* p. ii
[14] Craig, G. De Búrca, *op.cit.* p.1036
[15] Council Regulation (EC) No 139/2004, Art 3 (1).
[16] Commission Notice on the concept of concentration, para. 4. (O.J 1998, C66/02) (http://europa.eu.int/comm/competition/mergers/legislation/co406489_en.pdf)

A merger may occur, for example, when two previously independent firms merge into a new firm and cease to exist as separate legal identities or when an independent firm absorbs another independent firm, the former retaining its' legal identity and the later ceasing to exist as a legal identity[17].

The acquisition of control of a firm may occur by one firm acting independently or by two or more firms acting jointly. The control may also be acquired by a one or more persons in circumstances where that person/ persons already controls at least one other firm. The term "person" includes in these contexts public bodies, private entities as well as individuals[18].

The Merger Regulation only regulates operation bringing about a change of control. Control is defined in Article 3 (2) in the Merger Regulation as the possibility to exercise decisive influence on an undertaking on the basis of rights, contracts or any other means.

Also the creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity shall be considered to be a concentration within the meaning of the Merger Regulation[19].

2.3 Community dimension

In order for the Merger Regulation to apply the concentration must have a Community dimension. A concentration with Community dimension should be deemed to exist where the aggregate turnover of the undertakings concerned exceeds certain given thresholds. The thresholds are given in Article 1(2) of the Merger Regulation which states that a concentration has Community dimension where:

(a) the combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 5 000 million; and

(b) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 250 million,

unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

This is irrespective of whether or not the undertakings effecting the concentration have their seats or their principal fields of activity in the Community, provided they have substantial operations there.

---

[17] *Ibid.*, para. 6
[18] *Ibid.*, para. 8
[19] Council Regulation (EC) No 139/2004, Article 3(4)

3 Introduction and principles of efficiencies

This chapter provides a discussion about the theory necessary to give a coherent understanding of the role and importance of efficiency gains in merger assessments. The chapter starts to describe three different classes of efficiencies then continues to with a discussion about empirical studies made on efficiencies created by mergers.

Economists often distinguish between three different classes of efficiencies: Allocative efficiency, productive efficiency and dynamic efficiency. All three types are relevant in the analysis of the impact of a concentration on effective competition.

Allocative efficiency refers to the optimal situation when products are allocated between consumers according to the amount the consumers are willing to pay, prices never exceed marginal costs. Furthermore, allocative efficiency is achieved under perfect competition making it impossible for a producer to affect market price through lowering the level of output[20].

Productive and dynamic efficiency are narrower concepts than allocative efficiency. Efficiency gains essentially refer to these two classes of efficiencies. *Productive efficiency* (or supply-side efficiencies) is, as well as allocative efficiency, a static notion focusing on the performance of an economy, industry or firm for a given technology and existing knowledge at a given time. (Productive efficiency focuses on a specific firm or industry) It is achieved when goods and services are produced to lowest possible cost and output is maximized by using the most effective combination of inputs[21]. Generally it is these kinds of efficiencies that are focused upon in efficiency evaluations as they often can often be quantifiably measured and objectively ascertained[22]. Productive efficiencies amount for around 70 % of the strategic rational of mergers[23]. Examples of productive efficiencies are plant-level savings which refers to those savings that flow from specialisation, elimination of duplication or reduced inventory requirements or multi –plant-level savings arising from plant specialisation,

[20] Gerard, D; "Merger Control Policy: How to Give Meaningful Consideration to Efficiency Claims?" CML. Rev 2003; 40,6; ABI/INFORM Global p. 1368

[21] De la Mano, M; Enterprise Directorate-General European Commission, "For Costumer's Sake: The Competitive Effects of Efficiencies in European Merger Control" (2002) Enterprise Paper No 11. p. 8

[22] Piaskoski, M, Finkelstein, N;" Do Merger Efficiencies Receive " Superior" Treatment in Canada? Some Legal, Policy and Practical Observations Arising from the Canadian Superior Propane Case" World Competition, 2004, 27 (2), p. 271

[23] Habeck, M, KroÈger, F and TraÈm, M; *After the Merger, Seven Strategies for Successful Post-Merger Integration* (Pearson education Limited, London, 2000) p. 7

rationalisation of management functions or the rationalisation of R&D activities[24].

The concept (in antitrust economics) of *Dynamic efficiency* (or demand-side efficiencies) is connected with whether there is enough incentive and ability to innovate and increase productivity over time. It is achieved when producers, as part of wish for winning market shares, constantly innovate and develop new products which consequently may result in cheaper, better or new goods that will satisfy consumer. Hence dynamic efficiency provides great potential of enhancement of social wealth as they result in introduction of new improved products[25].

Effective competition may be said to prevail when producer are continuously forced to satisfy the consumers' wishes for lowest price (allocative efficiency) while using the fewest resources (productive efficiency), and thereby encourages innovation and progressiveness (dynamic efficiency)[26].

However, theses three classes of efficiencies might not necessarily be consistent with each other. For instance, a concentration might cause a reduction in allocative efficiency at the same time as productive efficiency increases as an effect of economy of scale or rationalisation. Therefore the competition authorities must engage into a complex balancing test when determining whether or not the merger will result in any net efficiencies.

3.1 Empirical evidence

Under normal circumstances most mergers are expected to create efficiency gains. However this might not always be the case. Although the relevance of the empirical studies made is fairy limited it might at lest help us to estimate to some degree the extent and magnitude of efficiency gains.

Empirical studies made in 2001[27] have identified facts in relation to the impact of mergers on profitability or welfare. According the studies mergers tend to:

- Reduce the profit margins of the acquiring firm.
- Have no obvious positive effect on either sales or market shares.
- (Horizontal) mergers tend to reduce the level of R&D investment.

[24] Piaskoski, M & Finkelstein, N; *op.cit.* p. 271
[25] *Ibid.,* p.274
[26] Luescher, C "Efficiency Considerations in European Merger control- Just another Battleground for the European Commission, Economists and Competition Lawyers" E.C.L.R 2004 25(2) p.73
[27] Trichy, G. (2001) "What Do We Know About The Success and Failure of Mergers" *Journal of Industry Competition and Trade*, 1(4) p. 347-394.

- Take-overs involving innovative small enterprises often have a rather strong negative impact on the performance on these firms[28].

Furthermore, empirical studies show that merged firms tend to perform better if they before the merger were active in similar markets or produced similar products. They also tend to perform better if the means of payment is cash, in contrast to stock, and if the merging firms have a similar style of management[29].

Empirical evidence regarding the impact of mergers on efficiencies *per se* is still unclear. However, in an attempt to distinguish between efficiency gains and market power effect it was found that at best half of the mergers are profitable[30].

An empirical study like this might fuel views such as; a high rate of merger failure shows that merger related efficiencies are negligible. However, Miguel de la Mano in Enterprise paper No 11[31] suggests that this view is a mistake since it is still necessary to determine whether significant efficiency gains may be associated with the remaining half of successful mergers, as oppose to the increased market power and since efficiency gains may be significant even though the competitive environment post-merger may be tougher than the merging parties had anticipated.

Mano continues to state that the empirical evidence shows that the conservative assessment of efficiencies by the Commission is justifiable and that the Commission must be aware of managers' tendencies to overestimate the future efficiency gains from mergers.

---

[28] *Ibid*., p. 347-394
[29] *Ibid*., p 347-394
[30] Gugler, K., D.C. Mueller, B.B. Yurtoglu and C. Zulehner, "The Effects of Mergers: An International Comparison" International Journal of Industrial Organization, (2002) Forthcoming
Available at: http:// mailbox.univie.ac.at¨? muelled2/effects.pdf
[31] Enterprise Papers No 11 *op. cit*. p.6

4 The new substantive test under the Merger Regulation

To be able to evaluate the relevance of efficiencies under the New Merger Regulation it is important to understand the reasons behind the change of the substantive criterion for the merger review and the alleged differences between the old and new test.

This chapter provides a summary of the development of the law leading to the change of the substantive criterion. It starts out to describe how mergers where dealt with by the Commission under the dominance test used under the Old Merger Regulation[32]. In particular the chapter provide an analysis of precedents where the Commission has evaluated efficiencies prior to the merger control reform.

The chapter, further, describes the substantive criterion under New Merger Regulation and it includes some aspects of the discussion and concerns prior of the change. Finally the chapter describes the Horizontal Merger Guidelines and what kinds of anticompetitive effects that might concern the Commission in the merger review.

4.1 The Dominance test under the Old Merger Regulation

A concentration within the scope of the Merger Regulation shall be appraised in accordance with the objectives and provisions of the Merger Regulation with a view to establish whether or not they are compatible with the common market[33].

The reform of the merger regulation included among other things a change in the substantive criterion for apprising mergers. The substantive criterion of merger policy decides whether or not a concentration is compatible with the common market. Under Old Merger Regulation the test for compatibility with the common market is in following terms:

"*A merger which creates or strengthens the dominate position as a result of which effective competition would be significantly impeded, in the common market or in a substantial part of it shall be declared incompatible with the common market[34].*"

---

[32] The Merger Regulation (ECC) No 4064/89 on the control of concentrations between undertakings [1989] OJ L395/1

[33] Merger Regulation (EC) No 139/2004, Article 2.

[34] Merger Regulation (EEC)No 4064/89 Article 2 (3)

4.1.1.1 Scope and assessment

The substantive criterion used in Old Merger Regulation is called a dominance test and it is focusing on whether or not the concentration will create or strengthening a dominate position in the common market[35]. The dominance test follows a more structural approach than the new SIEC-test (Substantial Impediment of Effective Competition),used under the New Merger Regulation, as it focuses on market shares and on the market definition[36].

The motivation to use a dominance test in the Old Merger Regulation is not quite clear. However a plausible explanation could be that the notion of dominance already was used in Article 82 of the Treaty and that this could have brought some familiarity to the concept making it easier to employ.

In order for a concentration to become prohibited it must fulfil the requirements set out in the substantive criterion. The dominance test could be looked upon as being constructed of two "limbs". The first one requiring the concentration to create or reinforce a dominate position in the relevant market and the second limb requiring the concentration to result in an impediment of effective competition. However, whether or not the two limbs were independent of each other, representing two parts in the overall assessment of the concentration or two distinct steps in the assessment of the concentration was always a mater of uncertainty[37].

Most cases raising competition concerns under the dominance test involves the likely creation or strengthening of a single firm in a dominate position. Nevertheless, when looking at the case law it is clear the test has been applied in a dynamic manner[38]. For instance the test has been applied in cases involving collective dominance[39] such as the *Airtours/ First Choice*[40] case or in cases such as *Vivendi/Canal+/Seagram*[41] where the test was applied to anti-competitive effects resulting from mergers between no-

[35] Voigt, S & Schmidt, A; "Switching to Substantial Impediments of Competition (SIC) Can Have Substantial Costs- SIC" E.C.L.R 2004, 25(9) 584-590 p. 584.
[36] McDavid, J "Proposed Reform of the EU Merger Regulation: A U.S Perspective" (2002) 17 Antitrust 52, at p.54
[37] Fountoukakos, K & Ryan, R; "A Substantive Test for EU Merger Control" E.C.L.R, 2005, 26(5), p. 277-296
[38] *Ibid.*
[39] Many mergers are created in markets that show signs of being fairly concentrated already before the merger has taken place. Where a merger results in a new market leader the test for single firm dominance will be appropriate, however if the merger takes place in a market with few competitors but where no new market leader is created, competition will still be reduced and the merger will be detrimental to competition. The only way to address this problem under the dominance test is to apply the notion of collective dominance asking whether or not a group of firms, to which the merging firms belong, can be considered to hold a position of collective dominance. Andreas Weitbrechet, "EU Merger Control in 2004- An Overview" E.C.L.R, 2005, 26(2), p. 67-74.
[40] *Air tours/Commission* (Case T-342/99) 6 June 2000
[41] *Vivendi/Canal+/Seagram* (Case COM/P 2050) 13 october 2000

competing firms (vertical merger). The test has also been applied in cases such as *Tetra Laval/Sidel* where the merging parties where active in neighbouring product markets.

The approach to efficiencies under the EC Merger Regulation has always been controversial. Although Article 2(1) of the Old Merger Regulation states that technical as well as economic progress has to be taken account provided that it is to the consumers' advantage and does not form an obstacle to competition, little weight has been given to efficiencies in the merger assessment under the Old Merger Regulation.

Nevertheless, economists have long advocated an incorporation of an efficiencies analysis in the merger review and there is evidence that the Commission has evaluated efficiencies in some cases, although the final outcome of the evaluations was contradicting creating confusion in this area of law. In most cases the Commission has recognized efficiencies as a pro-competitive effect generated by the merger, but there are also cases were efficiencies have been seen as a penalizing factor. So far there is no case where efficiencies have made the Commission clear a concentration that was found creating or strengthening a dominate position as a result of which effective competition would be impeded.

4.1.1.2 Decisional practice of the Commission relating to efficiencies under Old Merger Regulation

In the assessment of whether or not a merger is compatible with the common market the Commission generally follows a classical four step analysis consistent of; a) the market position of the merged firms i.e. the market shares and other advantages over competitors, b) the structure of supply i.e. the strength of remaining competitors post- merger c) the structure of demand i.e. the buying power of costumers and d) the potential competition.

Under the Old Merger Regulation, the evaluation of efficiencies was far from a standard step in the merger assessment. Nevertheless, the current view of efficiencies represents the outcome of the development of case law where the Commission has taken efficiencies into account in their merger assessment.[42] These cases are a few examples of were the Commission has evaluated efficiencies under Old Merger Regulation.

Aerospatiale- Alenia/Havilland

The landmark case for efficiencies under the Merger Regulation is the *Aerospatiale- Alenia/Havilland* case[43]. The case concerned a proposed acquisition by Aerospatiale and Alenia of the Havilland division of Boeing.

---

[42] Camesasca, P;"The Explicit Efficiency Defence in Merger Control: Does it Make the Difference" E.C.L.R 1999, 20(1) p. 22

[43] *Aérospatiale-Alenialde/ de Havilland* (Case IV/M.053) 2 October 1991, para 65-72

The parties argued that one of the objectives of the acquisition was to reduce cost i.e. they claimed an efficiency defence in order for the Commission to justify the acquisition.

The Commission rejected the argument by saying that the claimed cost savings (amounting to 0.5% of the combined turnover) were not sufficient enough to contribute to technical and economic progress within the meaning of Article 2(1)b of the Old Merger Regulation. The Commission also stated that even if the cost savings would have been enough, they would not have been to the consumer's advantage.

The case shows that the Commission did not rule out the possibility of efficiency claims[44] in the merger assessments although, in this particular case, the proposed efficiencies only demonstrated a negligible impact. The case further shows that in order for the Commission to take into account efficiencies they have to be "merger specific", substantial and to the consumers' advantage.

Mercedes/Benz/Kässbohrer

There are also other cases where efficiencies have been considered by the Commission in its merger review. The *Mercedes/Benz/Kässbohrer*[45] case, which concerned the acquisition of Kässbohrer by Mercedes-Benz, is an example where efficiencies were recognised as a positive factor in the concentration assessment.

In this case the Commission recognised that the transaction would allow the firms to achieve certain synergy effects relating to production, research, development and administration but the importance of the synergy effects[46] achieved by the merger would only been limited. However, it remained unclear what influence the efficiencies would have had on the Commission's position regarding the acquisition, if they had been considered significant.

ABB/Daimler-Benz

Another case where the Commission can be considered to have evaluated efficiencies under Old Merger Regulation is the *ABB/Daimler-Benz*[47] case. The case involved a proposed joint venture between ABB and Daimler Benz. ABB and Daimler-Benz wanted to transfer their world wide rail technology to a joint venture.

[44] The term "efficiency claims" is used to describe the claims of the creation of efficiencies by the parties to a transaction under review by the competition authorities.
[45] *Mercedes/Benz/Kässbohrer,* (Cases IV/M.477) 14 February,1995, Para. 65-66
[46] Synergies are the marginal cost savings or quality improvements arising from any source other than the realisation of economies of scale. Examples include the close integration of specific, hard-to-trade assets, improved interoperability between complementary products and the sharing of complementary skill. Piaskoski &Finkelstein p.272
[47] *ABB/Daimler-Benz* (Case IV/M 580) 18 October, 1995, para.63-65, 112

After the Commission had evaluated the synergies that the transaction would involve, for example higher level of capacity utilization, it concluded that on the competitive conditions in general, the transaction would not worsen the situation. Instead it said that "structurally speaking it would tend to improve it". It further explained that this was because it could be assumed that the cooperative arrangements entered into in the passed were the result of lack of competitors in the market and that after the transaction significant competition inside the duopoly would arise as the cooperation on a specific project between the previous actors might come to a stop.

According to Camesasca this case clearly shows that efficiencies had become more in the centre in the merger assessment and that the purported efficiencies in the case played some part in the final outcome[48].

Market shares represent an important factor of evidence of a dominate position in a market, nevertheless, there are also other factors, such as for example dynamic aspects of the market, that the Commission takes into account in it's merger assessment. In the case law where efficiencies have been evaluated under the Old Merger Regulation efficiencies have been assessed as a factor in the overall assessment of the merger's compatibility with the common market. The case law also shows that in at least some cases efficiencies have played a part for the Commission's the final decision.

4.1.1.2.1 "Merger-specific", "substantial" and "passed-on" to the consumers

<u>*Nordic Satellite Distribution*</u>

It was furthermore confirmed in the case of *Nordic Satellite Distribution*[49] that efficiencies have to be "merger-specific" in order for the Commission to take them into account in the merger assessment. The case involved the proposed creation by TeleDanmark, Telenor and Kinnevik of the joint venture Nordic Satellite Distribution (NSD). NSD was concerned with distribution of satellite TV to the Nordic market. Telenor was a public Norwegian telecom operator, TeleDanmark was a Danish Telecom operator, and Kinnevik a Swedish industrial group with large interests in media.

The Commission recognised that the joint venture would involve significant efficiencies but it was also concerned that the joint venture would result in the parties achieving a strengthening of a dominate position in several markets. The Commission ended with concluding that the anti- competitive effects that would arise from the merger would not be deemed necessary in

[48] Camesasca *op.cit.,*p. 26 Other cases where the Commission, according to Camesasca, considers efficiency gains under the Merger Regulation 4064/89 is *Alcatel/Telettr*[48] (Case IV/M. 042) 4 April, 191, M*annesmann/Valourec/Ilva* (Case IV/M . 315) 31 January , 1994,
[49] *Nordic Satellite Distribution* (Case IV/M. 490) 19 July 1995

order to achieve the efficiencies[50]. Hence the case indicates that efficiencies have to be "merger-specific".

Accor/Wagon-Lits

Moreover, the requirement that the efficiencies have to be passed on to consumers was confirmed by the *Accor/Wagon-Lits*[51] case. The case concerned the proposed acquisition by Accor SA (Accor) of all the shares still in circulation of the Compagnie Internationale des Wagons-lits et du Tourisme (CIWLT). Accor was a French catering and hotel group and CIWLT was a Belgian catering, hotel and tourism group.

The Commission was concerned that the transaction would result in a dominate position in the motorway catering sector. The parties argued, among other things, that the operation would result in efficiencies but the Commission observed that the claimed efficiencies were not "substantial" enough and even though they might exist they would not have been passed on to the consumers.

4.1.1.2.2 An efficiency "offence"?

AT&T/NCR

The Commission has, nonetheless, in some cases interpreted efficiencies as a way for a firm to increase market power and thus exercise some kind of exclusionary practise. One example of this is the *AT&T/NCR* case[52]. The case concerned an acquisition of the NCR Corporation (NCR) by American Telephone & Telegraph Company's (AT&T).

The Commission believed that there was a potential complementarity in the technical field, the workstations and communication products. They were concerned that theses synergies might give AT&T/NCR the chance of developing a more advance communication features at lower cost.

Furthermore, the Commission stated that "it is not excluded that potential advantages flowing from synergies may create or strengthening a dominate position". This shows what the Commission may in certain particular situations consider efficiencies as an offence. However, in the case of AT&T/ NCR the efficiency argument put forward by the parties was dismissed as there were other competitors on the market imposing constraints on the acquisition and since the claimed efficiencies were just theoretical and had not yet been proven in any future markets.

[50] *Ibid.,* para. 145-151: See also the Commission's summary of the case in it's contribution to O.E.C.D ./GD(96)65.
[51] *Accor/Wagon-Lits* (Case IV/M126) 28 April 1992 Para.26. 2(f)
[52] *AT&T/NCR* (Case IV/M.05) 18 January, 1991, [1991] O.J. C16/127

Airtours/First Choice

After the Commission had found the concentration *Airtours/First Choice*[53] detrimental to effective competition the case was appealed to the CFI. In its judgement the CFI seriously doubted the relevance of the proposed efficiencies, in the form of economies of scale and scope, produced by the vertical integration of tour operators. It was uncertain that the proposed efficiencies were relevant to the question of the ability of small operators to respond effectively to the anti-competitive effects that the concentration would bring as a result of collective dominance.

The debate around the efficiency defence is at least according to Damien Gerald[54] based on the misunderstanding of the merger regulation and ambiguous statements from the Commission and the CFI. This can be seen as a plausible explanation not only because Monti[55] has denied the existence of an efficiency offence, but also considering the development of the law and the treatment of efficiencies under the Horizontal Merger Guidelines.

4.1.1.3 Concerns about the old dominance test

The dominance test raised lots of criticism from both among practitioners and scholars. One of the main criticisms arose from the alleged gap for mergers which resulted in unilateral effects in oligopolistic market (i.e. market with only a few producers of a product or a service)[56].

Although the Commission interpreted the dominance test as being equivalent to substantial market power and thus being able to challenge all kinds of mergers, it was argued that the dominance test did not, strictly speaking, challenge mergers that did not result in the creation or strengthening of a dominant position and that the dominance test therefore created in legal uncertainty in certain areas of EC merger control.

Furthermore, the dominance test was also criticised for failing to asking the question whether the concentration actually harmed the consumer welfare.[57]

4.2 The SIEC test- an improvement or

[53] *Airtours v. Commission* (Case T-342/99) 6 June 2000 paras. 211-216, also see Gerald p.1405
[54] Gerald *op. cit*. p.1404
[55] Monti, *Roadmap for the reform prodject*, Conference on the Reform of European Merger Control, British Chamber of Commerce in Brussels (June 4 2002)
[56] Maudhuit, S & Soames, T ;"Change in EU Merger Control: Part 2" E.C.L.R 2005, 26(2) 75-82. In essence it was argued that the dominance test focused on whether or not the merger would create or strengthen the dominate position in the common market instead of the effect on competition and thus the test could, in certain situations, result in clearance of anti-competitive mergers.
[57] *Ibid.*

impediment?

After CFI had overturned the Commission's decisions in the case of *Airtours/ First Choice*[58], *Schneider/ Legrand*[59] and *Tetra Laval/ Sidel*[60] the Commission received lots of criticism which enhanced the need for a reform of the merger control[61]. The proposal of the New Merger Regulation was the result of a long period of review starting in 2000 with the submission of a Report to the Council on the functioning of the Old Merger Regulation and in January 2004 the Merger Regulation came into force[62].

The reform concerned jurisdictional, procedural and substantive issues aiming to substantially improve the merger control system. This was made through minimising transaction costs for businesses through the one-stop-shop system and through improving transparency and speed of the assessment procedure, thus improving legal certainty[63]. As the Commissioner Mario Monti said "The new law will equip the European Union, with a modern more flexible and efficient legislation…."[64]

At present date there is not much case law under the new substantive test and it is for the future to show how the Commission and the European Courts will interpret it and how efficient the test really is.

The substantive criterion in New Merger Regulation reads as follow:

"*A concentration which would significantly impede effective competition, in the common market or a substantial part of it, in particular as a result of the creation or strengthening of a dominate position, shall be declared incompatible with the common market"* [65]

Factors that will be taken account to in the appraisal of a concentration will include:

- The need to maintain and develop effective competition within the common market in view of, among other things, the structure of all the markets concerned and the actual and potential competition from undertakings located either within or outwith the community
- the market positions of the undertakings concerned and their economic and financial power,

---

[58] *Airtours plc* v. *Commission*, (Case T-342/99) 6 June 200 paras

[59], *Schneider Electric SA* v. *Commission*, (Case T-310/0), 22 October 2002

[60], *Tetra Laval BV* v. *Commission*, (Case T-5/02) 25 October 2002

[61] Monti, M; European Commissioner for Competition Policy, "Merger control in the European Union : a Radical Reform", European Commission/IBA Conference on EU Merger Control, Brussels, 7 November 2002.

[62] Commission Regulation 802/2004 implementing Merger Regulation No 139/2004

[63] I. Kokkoris, "The Reform of the European Control Merger Regulation in the aftermath of the Airtours Case- The Eagerly Expected Debate: SLC v Dominance Test" ECLR 2005, 26 (1), p. 37-47

[64] Press release. IP/04/07 "EU gives itself new merger control rules for 21st. century."

[65] Merger Regulation (EC) No 139/2004, Article 2(3).

- the alternatives available to suppliers and users,
- their access to suppliers or markets,
- any legal or other barriers to entry,
- supply and demand trends for the relevant goods and services,
- the interests of the intermediate and ultimate consumers
- and the development of technological and economic progress provided that it is to the consumers' advantage and does not form a obstacle to competition[66]

4.2.1 Scope and assessment

The emphasis in the new test is whether or not the concentration will cause impediment to effective competition in the common market or a substantial part of it. This corresponds to the second "limb" of the old dominance test. The former decisive criteria; whether or not the concentration results in the creation or strengthening of the common market, has now been transformed into the prime example of an impediment to effective competition. This means that it is no longer crucial that a concentration, to be caught by the Merger Regulation, must create or strengthen a dominate position of the merger, it is enough that the concentration causes impediment to effective competition. Overall the new substantive test puts less focus on market dominance and market structure and focuses more on competitive effects of the merger[67]. This approach has open up for a more extensive evaluation of efficiencies in the assessment of the concentration.

Furthermore, the fact that the test states that effective competition is impeded "in particular" as a result of the creation and strengthening of a dominate position, may eliminate any previous concerns about whether or not it is a two or one limb test[68]. The new substantive test is one limb test focusing on whether or not the concentration is impeding effective competition.

4.2.2 The "European solution"

In response to the criticism of the old dominance test the new substantive test is designed to catch all possible post- mergers likely to impose a threat to the effective competition in the common market, including mergers leading to unilateral effects in situations of oligopolies[69].

It had been long debated whether or not the Commission had the competence to intervene in theses situations and if there was a possible

[66] *Ibid.,* Article 2(1)
[67] Colley, L; "From "Defence" to "Attack"? "Quantifying Efficiency Arguments in mergers" E.C.L.R 2004, 25(6) p. 342-346.
[68] Fountoukakos & Ryan *opt.cit*., p. 277-296
[69] Recital 25, Merger Regulation No 139/2004; See also, the Commission's press release, IP/04/70 "EU gives itself new merger control rules for 21st century" 20/01/2004

“gap” in the dominance test[70]. Some commentators wanted to change the test to a SLC test (Substantive Lessening of Competition) used in many other jurisdictions for example Canada, USA and UK. This test is considered more flexible and more economics-based[71], superior in dealing with efficiency arguments and would and according to its agitators closes a possible “gap” that the dominance test might have. Furthermore the commentators argued that a change to the SLC test would lead to convergence in global merger control.

Nevertheless, other commentators argued that the dominance test was capable of controlling even these special situations and that a change to the SLC test would render previous precedent useless. Even though a change to the SLC test would result in better convergence globally, in the European market it would cause more uncertainty since most European countries use the dominance test[72].

As a compromise between these two tests, the SIEC-test, (Significant Impediment of Effective Competition) was finally agreed upon. The SIEC test is suppose to bring about the best from both tests making the assessment more flexible with stronger focus on economics and effects[73].

Today there are three different tests used to assess concentration in Europe, the dominance test, the SLC test and now the SIEC test. There might be a possibility that the use of three different kinds of substantive criterion in the review of mergers in the European market will results in more legal uncertainty rather than legal certainty.

4.2.3 Possible effects due to the reform

Due to the change of the substantive criterion in the merger review under the New Merger Regulations concerns were raised about an increased discretion on the behalf of the Commission. Under the new substantive criterion the Commission has the power to challenge concentrations that significantly impede competition but not necessarily creates or strengthen a dominate position in the market. What does then “significantly” impede effective competition mean?

This term can be interpreted in many different ways, left to the discretion of the Commission. Hence the new wording of the substantive criterion in the

[70] See chapter 3.2.2. After the ruling of the Airtours case it was argued by some commentators that there was a possible “gap” in the dominance test. The “gap” concerned failure by the test to, in specific situations, catch mergers in oligopolistic market structures bringing about unilateral effects.
[71] Schmidt, J; ”The new ECMR: ”Significant Impediment” or “Significant Improvement” Common Market Law Review 41: 1555-1582, 2004 p. 1564
[72] Böge and Müller,” From the Market Dominance Test to the SLC Test: Are there any Reasons for a Change?” 23 E.C.L.R. (2002) p. 495, 498.
[73] Schmidt, J;*op. cit.,* p. 1565

New Merger Regulation may be seen to have increased the Commission's power. However, the Commission has made clear that the policy under the new substantive test will not be more interventionist than the policy under the old dominance test[74]. Nonetheless, maybe the Commission will not act more interventionistic than under the old dominance test in the nearby future, but how will it act in a couple of years? The new substantive test has open up for a more extensive power for the Commission.

Usually, decisions in merger policy are observed by more than the involved parties. The case will be used by others in the market and will become a precedent. The Commission has emphasised that the reform is only to be seen as a clarification[75], however, some sort of a change in the law has occurred or otherwise there would not have been a reform. Any change in the law will, at least in the beginning, before any precedents have been formed, result in legal uncertainty since the actors in the market do not know how to interpret the legal rules. The assessment of efficiencies is a prime example of this issue.

The importance of predictability is overwhelming in legal systems. Legal uncertainty can be transformed into higher costs[76] and the lack of predictability may be detrimental to the realisation of welfare gains. If market actors believe that a future merger might not pass the appraisal of the Commission the parties might not engage in the merger and welfare gains might be lost. The same result may occur if parties believe that their merger may pass the Commission’s appraisal and they invest in the entity to be created and then the merger is prohibited. At present date not may precedents exists under the New Merger Regulation and although old precedents is considered to be valid even after the reform the situation is confusing.

Irrespective of the opinions on these matters it is interesting to see where the new substantive test is going to bring us in the future. New case law is going to be created by the Commission and the European Courts and it is apparent from the reform and the discussion leading to the reform that the Commission has shown a willingness to have a more economic-based approach, focusing more of the effects on effective competition. This could bee seen as a step in the direction towards US merger control and it might help reduce the tension between the US competition authorities and the Commission shown in for example the *General Electric/ Honeywell*[77] case.

The more economic based approach of the test, together with the explicit introduction of efficiencies into the New Merger Regulation implies that the position of efficiency claims, in the assessment of merger, is strengthened. It is now stated in the Horizontal Merger Guidelines that the Commission will

[74] Commission Press Release 20/01/2004, MEMO 04/09.
[75] See *supra note* 49
[76] See *supra note 40* Voigt, S & Schmidt. p. 584-590
[77] *General Electric/ Honeywell* (Case COMP/M. 2220), 3 July 2001

consider efficiencies as a counteracting factor to anti-competitive effects brought about by the merger. These improvements allow for a greater scope of economic efficiency arguments than previously thought. However, even though efficiencies have been introduced to the EC merger regulation many ambiguities still remain some of which I am going to discuss further below.
Even though the change of the test, used by the Commission to assess whether or not a concentration is compatible with the common market, can been criticised and commented upon it must be concluded that the change has given the Commission a more flexible and efficient test to work with. As more precedents will be created the new Merger Regulation will be more predictable and even thought the change in the short run might cause some confusion and uncertainty, in the long run it helps create a more effective merger control for the European market.

4.3 The Horizontal Merger Guidelines

In order to reduce confusion and to increase legal certainty the Commission has published a notice on how the Commission assesses horizontal mergers: the Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings. Horizontal mergers are considered to be the most dangerous type of mergers to effective competition. One reason for this is that they may reduce the number of competitors in the relevant market and thus reduce the level of rivalry.

Guidelines have long been used in US merger policy[78], while in the European policy they have only been used reluctantly. Nevertheless, when it comes to the Merger Regulation they are well needed although its effectiveness may be questioned is some circumstances[79].

Article 2 of the New Merger Regulation provides that the Commission has to appraise concentrations within the scope of the Regulations with a view of establishing whether or not they are compatible with the common market. For that purpose the Commission must assess whether or not a concentration would significantly impede effective competition.

The Commission will prevent mergers that are likely to deprive consumers of benefits, such as low prices, high quality products and innovations, by significantly increasing market the power of firms [80]. In the assessment of the competitive effects of mergers, the Commission compares the

[78] Voigt, S & Schmidt, A ”The Commission’s guidelines on Horizontal Mergers: Improvement or Deterioration?” CML Rev. 2004; 41, 6; p. 1584
[79] *Ibid.*
[80] By ”increased market power” is meant the ability of one or more firms to profitably increase prices, reduce output, choice or quality of goods and services, diminish innovation or otherwise influence parameters of competition. *Ibid.* para 8.

competitive conditions that would result from the merger with the conditions that would prevail without the merger[81].

The Commission will assess the relevant product and geographical market and then further make a competitive assessment of the mergers. In order to assess the foreseeable impact of a merger the Commission will analyse the possible anti-competitive effects and relevant countervailing factors of the mergers in the relevant market such as buying power, efficiencies and barriers to entry.

The guidelines mention that there are two main ways in which horizontal mergers may significantly effective competition;

by "eliminating important competitive constraints on one or more firms, which consequently would have increased market power, without resorting to coordinated behaviour (non- coordinated effects)"[82]

and by "changing the nature of competition in such a way that firms that previously were not coordinating their behaviour, are now significantly more likely to coordinate and rise prices or otherwise harm effective competition." (coordinated effects)[83].

4.3.1 Non-coordinated effects

A merger may significantly impede effective competition in a market by removing competitive constraints. The most direct effect of the merger will be the loss of competition between the merging firms. This might result in, for instance, increased prices[84]. For example prior the merger the two firms were competing about the consumers. If one firm raised its prices consumers would most likely switched to the other competing firms' product causing less profit for the firm that increased its prices. When two competitors merge these competitive constraints are removed. Non- merging firms might also benefit from the merger. The reduction in these competitive constraints could lead to significant price increase of market power in the relevant market which can effect the consumer welfare. A merger giving rise to such non-coordinated effects (elimination of important competitive constraints) will, generally, significantly impede effective competition by creating or strengthening a dominate position of a single firm.

A number of factors may influence whether significant non- coordinated effects are likely to result from mergers. One factor is whether or not the merging firms have large market shares; another factor may be if the merging firms are close competitors. The higher degree of substitutability

[81] *Ibid*. para. 9
[82] *Ibid.,* para. 22 (a)
[83] *Ibid*., para. 22 (b)
[84] *Ibid.,*para.24

between the merging firms' products the more likely it is that the merging firms will increase prises significantly.

Other factors that might influence whether significant non- coordinated effects are likely to result from a merger might be if costumers have limited possibilities to switch supplier, either because they face substantial switching cost or because there are few alternative suppliers or if competitors are unlikely to increase supply if prices increase. Further factor that might influence are if the merged entity is able to hinder expansion by competitors or if the merger eliminates an important competitive force[85].

4.3.2 Coordinated effects

A merge may cause coordinated effects. This specifically happens in markets where the structure may be such that that firms would consider it profitable, economical rational and hence preferable, to adapt on a sustainable basis a course of action on the market aimed at selling at increased prices. Firms may coordinate in different ways. One way could be to keep prices above competitive level, another way could be to limit production or the amount of new capacity brought to the market. A third way of coordination could be to divide up the geographical market[86].

In the lights of these elements the Commission determines whether the mergers significantly impedes effective competition, in particular through the creation or strengthening of a dominate position, in the common market.

[85] *Ibid.,* para. 27- 38
[86] *Ibid.,* para. 39- 40

5 Efficiencies under current EC merger control

The treatment of efficiencies under EC Merger Regulation has long been controversial. Although the old dominance test does not explicitly state anything about efficiencies there are signs that efficiencies have been taken into account to by the Commission in their merger assessments. However the case law is confusing since there is evidence that the Commission has used efficiencies both as a factor counteracting the harmful effects of mergers in the common market and as a penalising factor. No mergers have so far been cleared by the Commission because of efficiencies.

The explicit introduction of efficiencies in New Merger Regulation is an improvement of the situation although confusion still exists, how much weight will the Commission give to efficiency arguments in their assessment of concentrations? Will there be some kind of hierarchy among different types of efficiencies? What level of proof is to be imposed on the merging parties? Finally what is the relationship between the old precedents relating to efficiencies and the current Merger Regulation? These are only few questions that need to be clarified before the current situation can be considered completely satisfactory.

This chapter provides a description and an analysis of the legal framework regulating efficiencies under the EC merger control. It, further, compares the legal framework with the precedents under Old Merger Regulation and evaluates their correspondence comparing the weight given to efficiencies under the Old and New Merger Regulation.

The chapter, further, describes and evaluates the differences in the treatment of efficiencies generated by non- horizontal mergers to horizontal mergers. At last the chapter aims to clarify whether efficiencies shall be assessed as a factor in the merger review or if it can be used as an efficiency defence.

5.1 Legal framework

Article 2(1) in the Merger Regulation states that the Commission shall, when making the assessment of a concentration, take into account “the development of technical and economic progress provided that it is to the consumers’ advantage and does not form an obstacle to competition”.

The Merger Regulation further introduces, in Recital 29, the importance of efficiencies in the assessment of whether or not a concentration is compatible with the common market. It states that it is appropriate to take into account any substantiated or likely efficiencies put forward by the concerned firms in order to determine the impact of the concentration in the

common market and that it is possible that the efficiencies brought about by the concentration counteract the effects on competition that the concentration might otherwise have. It further states that as a consequence of the efficiencies the concentration may not significantly impede effective competition in the common market.

The purpose of the Horizontal Merger Guidelines is to provide guidance as to how the Commission assesses horizontal mergers. How this is done was discussed in short above[87]. When assessing the compatibility of a concentration the Commission takes into account the likelihood that possible efficiencies would act as a factor counteracting the harmful effects on competition which might otherwise result from the merger[88].

In order to assess whether or not a concentration significantly impedes effective competition the Commission perform an overall competitive appraisal of the merger taking into account any substantiated efficiency claims. The Commission may decide, as a consequence of the efficiencies that the merger brings about, that the concentration is compatible with the common market[89]. This will happen if the Commission is able to conclude that, the efficiencies generated by the merger are likely to enhance the ability and the incentive of the merged firms to act pro-competitively for the benefit of the consumers, thereby counteracting the adverse effects on competition which the merger might otherwise have.

For the Commission to take into account to efficiencies in its merger assessment and to be able to reach the conclusion that as a consequence of the efficiencies the merger shall not be prohibited, the efficiencies have to fulfil three cumulative requirements. They have to

- benefit consumers,
- be merger specific and
- be verifiable[90].

5.1.1 Benefit to consumers

When the Commission evaluates efficiencies in a merger assessment there will obviously be some kind of trade-off between different kinds of efficiencies[91]. The resolution of the outcome will depend on the relative weight given to the welfare of different participants on the market[92]. This is referred to as "welfare standard". There are two main forms of welfare standards guiding competition authorities in their merger policy: *consumer welfare standard* and *total welfare standard*. The former primarily focusing

[87] See chapter 3.3
[88] Horizontal Merger Guidelines., para. 10 (e)
[89] *Ibid.,* para. 77
[90] *Ibid.*, para 78
[91] See Chapter 4
[92] Miguel de la Mano, Enterprise Directorate-General European Commission. *op. cit.,* p.18.

on the welfare of consumers and the later primarily focusing on allocating the resources to those who evaluate them the most and thus treating producers (shareholders) and consumers neutrally[93]. The choice of welfare standard will affect different aspects of the merger assessment influencing what types of efficiency gains that the Commission is likely to take into consideration and to what extent they must be passed on to consumers.

The EC merger control tends to go along with the "consumer welfare standard". This was confirmed by Monti who stated that consumer welfare is "the goal of competition policy"[94]. The welfare standard approach can also be shown by various other examples. For instance Article 2 (1) states that the Commission shall, when making the assessment of a concentration, take into account "the development of technical and economic progress provided that it is to the consumers' advantage". Further Recital 29 in the Merger Regulations states "it is possible that the efficiencies brought about by the concentration counteract the effects on competition, and in particular the potential harm to consumers, that the concentration might otherwise have…" Moreover section 78 in the Guidelines states that in order for the Commission to be able to take into account to efficiencies they have to benefit consumers.

Many of the cases under the Old Merger Regulation, where the Commission examined the efficiency claims brought about by the merging parties, were dismissed because the efficiencies never were passed on to consumers. This was the case in for example the Saint-*Gobain/Wacker-Chemie/NOM*[95] case and *Accor/Wagon Lits* case[96].

In the merger assessments the Commission evaluates whether, overall, the efficiencies will give the consumers more gains compared to the anti-competitive effects created by the merger. According to the Horizontal Merger Guidelines the relative benchmark for assessing efficiencies is that the consumers will not be worse off as a result of the merger. The Guidelines further states that for "that purpose the efficiencies should be substantial and timely, and should, in principle, benefit consumers in those relevant markets where it is otherwise likely that competition concerns would occur"

Mergers may bring forward various types of efficiency gains leading to lower prices or other benefits for the consumers. The Guidelines lists efficiency gains that may lead to such benefits:

[93] Kiljanski, K; "Pass-on in Merger Efficiency Defence" World Competition 26(4) 2003, p. 653.
[94] Monti, M, *The Future of Competition Policy in The European Union,* Speech at the Merchant Taylor's Hall. 9 July 2001
[95] *Saint-Gobain/Wacker-Chemie/NOM,* (Case IV/M. 774), 4 December 1996, paras. 244-246.
[96] *Accor/Wagon Lits* IV/M 126, 28 April, 1992, at para 26 (2)f

- Efficiency gains that generate cost savings in production or distribution, as they may give the merged firms the ability and incentive to charge lower prices[97].
- Efficiency gains in the sphere of R&D and innovation as they may result in new or improved products or services [98]
- Efficiency gains increasing the merge firms' incentive to increase production and reduce prices and thereby reducing the entity's' incentive to coordinate its market behaviour with other firms in the market. Thus the efficiencies may lead to a lower risk of coordinated effects in the relevant market[99].

When making an assessment of the different efficiencies that the merger might bring it is important to differentiate between marginal cost savings and fixed cost savings as marginal or variable costs are more likely to be relevant in the assessment of efficiencies than in fixed costs[100]. This is because the reductions of marginal or variable costs are, in general, more likely to result in lower prices than reductions in fixed costs[101].

The greater the possible negative effects on competition of the merger, the more the Commission must make sure that that the claimed efficiencies are substantial, likely to be realised and be passed on to consumers to a sufficient degree. Further the later the efficiencies are expected to be materialised in the future, the less weight the Commission is going to assign to them.

It is highly unlikely that a merger leading to a market position approaching that of a monopoly will be declared compatible with the common market of the Commission on grounds that there are efficiencies counteracting its potential anti- competitive effects[102].

5.1.2 Merger specificity

In order for the Commission to take into account to an efficiency claim the efficiencies must be merger-specific[103]. This means that they are a direct consequence of the notified merger and cannot be achieved to a similar extent by less anti- competitive alternatives. Post- merger efficiencies might not always be specific to the merger since it might be attainable in another way, for example, through internal expansion, licensing or a specialisation agreement. It is for the merging parties to prove that there is no less anti-competitive alternative than the merger.

[97] Horizontal Merger Guidelines. Para. 80
[98] *Ibid.*, para. 81
[99] *Ibid*., para.82.
[100] *Ibid*., para.79
[101] De la Mano, M; Enterprise Directorate-General European Commission. p. 53
[102] Horizontal Merger Guidelines, para. 84
[103] *Ibid*., para. 86

5.1.3 Verifiability

Finally, in order for the Commission to take into account to an efficiency claim it must be verifiable. This means that the Commission should be able to be reasonably certain that the efficiencies are likely to

- materialise and
- substantial enough to counteract a merger's potential harm to consumers[104].

It will be easier for the Commission to evaluate the efficiency claims if they are convincing and precise. Where reasonable possible, the efficiencies and the resulting benefits to consumers, should be quantifiable. When there is not enough data available for this purpose, it must be possible to foresee that the efficiencies will have a clearly identifiable positive impact on the consumers, not a marginal one[105]. Evidence relevant to the assessment of the efficiency claim includes internal documents that were used by the management to decide on the merger, statements about expected efficiencies, historical examples of efficiencies or consumer benefits and pre-merger expert studies on the type and size of efficiencies and to what extent consumers are likely to benefit[106].

5.1.3.1 Burden of proof

Since there exists an asymmetry between the competition authorities and the merging firms with the regards to the information on the merger and the expected efficiencies it is up to the merging firms to provide the relative information demonstrating that the efficiency gains are merger-specific, likely to be realised and that the efficiencies will benefit consumers. It is recommended that the parties put forward all the relevant documents that they want that the Commission to consider in their merger assessment at an early stage[107].

In this context it must be remembered that it is very complicated to assess the feasibility of all the various contracts that can be pursued absent the merger and that this may lead to high costs for the merging firms. Not only because of the cost of the information needed to predict the extension of the purported efficiencies but also because efficiencies are speculative and often unquantifiable.

---

[104] *Ibid.*, para. 86
[105] *Ibid.,* para. 86
[106] *Ibid.*, para. 88
[107] DG Competition, Best Practices on the Conduct on the Conduct of EC Merger Control Proceedings, section 18

The parties must put forward enough evidence to make the Commission reasonable certain that the efficiencies are likely to materialise and be substantial enough to counteract a merger's potential harm to consumers. This can be considered demanding as to the scope of evidence but it is not unreasonable considering the conclusions of empirical studies showing that mergers do not necessarily generate as many efficiencies as expected.

Although the Guidelines states that marginal costs savings are more likely to be relevant in the merger assessment than fixed cost and lists examples of efficiencies that are likely to benefit consumers the Guidelines may be considered to give poor guidance about the relevance of different types of efficiencies in the merger appraisal. Indeed, efficiencies are created in different ways, have different impact on effective competition and counteract anti-competitive effects of mergers in different ways. Instead the Guidelines states that the Commission will consider any substantiated efficiency claim in the overall assessment of the merger.

Even though efficiencies are hard to quantify, verify and hard to fit into a precise and hierarchic list of efficiencies, a better of clarification of the relevance of different types of efficiencies would be helpful for the firm to improve the understanding of the merger assessment.

Furthermore, the Guidelines fails to give guidance on the relationship between efficiencies and dominance. If concentration creates or strengthens a dominate position in the market it is a strong indicator that the concentration will significantly impede effective competition and hence be prohibited by the Commission. However if the concentration not only creates or strengthens a dominate position in a market but also creates efficiencies, how will the Commission decide then, how much weight will be given the efficiencies in relation to the dominate position?

5.1.4 Case law versus Horizotal Merger Guidelines

The guidance set out in the Horizontal Merger Guidelines elaborates on the experience of horizontal mergers under the Old Merger Regulations. However, in the situation of efficiencies there is not much case law for the Commission to elaborate on and the case law were the Commission has evaluated efficiencies is inconclusive and confusing. This because there has not been any guidance in the law how to handle efficiencies apart from Article 2 (1) in the Merger Regulation, stating that technical as well as economic progress has to be taken into account to provided that it is to the consumers' advantage and does not form an obstacle to competition.

The question then arises if the Commission has succeeded to publish clear guidance corresponding to the previous case law or if not, how to interpret the precedents under the Old Merger regulation in relation to the Guidelines?

The long debate on the change of the substantive criterion together with the implicit introduction of efficiencies in the recital of the Merger Regulation and in the Guidelines indicate that efficiencies have been given a stronger position as a total in the assessment on merges compatibility with the common market.

Both the recital in the Merger Regulation and the Guidelines state that the Commission considers any substantiated or likely efficiency that the undertakings put forward. The fact that the Old Merger Regulation did not mention anything about putting forward efficiency claims might have refrained undertakings from doing so in the belief that the efficiencies would not be taken into consideration by the Commission in their merger review and although parties have put forward efficiency claims the evaluations of them by the Commission have been restrictive. Furthermore, also the fact that there are cases where the Commission has interpreted efficiencies as efficiency "offence" might have resulted in reluctance to put forward efficiency claims in fear of that they may be used as an aggravated factor.

In the case of *AT&T/NCR* the Commission stated that "it is not excluded that potential advantages flowing from synergies may create or strengthening a dominate position". Some commentators argue that this could be seen as a formulation of an efficiency "offence". Other commentators argue that the debate about an "efficiency offence" is due to some ambiguous statements of the Commission and the misunderstanding of Article 2 of the Old Merger Regulation[108]. Nonetheless, the Horizontal Merger Guidelines gives no indication that an efficiency claim can be used as an efficiency "offence". Although valid cases law still exists indicating a possibility to an efficiency "offence" the Guidelines should be able to overrule those cases. However, if this is not the situation, the risk that the Commission would use efficiencies as an offence is very small.

Moreover, *Aerospatiale- Alenia/Havillan*[109]*, Nordic Satellite Distribution*[110] and *Accor/Wagon-Lits*[111] all indicate that in order to the Commission to take into account efficiencies they have to be "merger specific" substantial and be passed on to consumers i.e. benefit to the consumers. These requirements have been passed on to the Guidelines and can be found as the three main requirements that the Commission will consider at in their merger assessment, The Guidelines has, further, clarified these concepts in depth explaining the concepts of "benefit to consumers" and "merger specificity" in detail.

[108] D. Gerard, *op.cit.,* p. 1404
[109] *Aérospatiale-Alenialde/ de Havilland* (Case IV/M.053) October 2, 1991, para 65-72
[110] *Nordic Satellite Distribution* (Case IV/M 490) 19 July 1995
[111] *Accor/Wagon-Lits* (Case IV/M126) 28 April 192 Para.26. 2(f)

5.2 Efficiency effects of non-horizontal mergers

The question then arises how the Commission assesses efficiency effects of non-horizontal mergers. Is there any difference between the assessment of horizontal mergers and non-horizontal merger when it comes to the evaluation of efficiencies?

While horizontal mergers bring together competing actors in the market and thus remove direct competitive constraints which may result in higher prices or lower quality to the detriment of consumers, non- horizontal mergers do not have this effect. Instead these kinds of mergers generally give incentive to the merged firms to lower their prices. For instance, prior the merger the firms could not do anything about the fact that firm producing complementary products has high marginal costs, however, post-merger the merged firms want to eliminate double marginal cost to increase the entity's profit. Furthermore, in a complementary relationship a decrease in the price of a product may increase the sales of another product. For example a reduction in the price of a computer may increase the sales of keyboards[112].

However although these price reductions generally are pro-competitive there are situation where they also can have an anti-competitive effects. As the direct competition is not removed in situations of non-horizontal mergers, the anti- competitive effects arise indirectly through for example refusal to supply. Post merger, refusal to supply might reduce competitors to the extent that they become marginalised or forced out of the market. A scenario like this would enable the merged firm to increase its prices[113]. This is provided that the rival firms were unable to respond to the behaviour of the merger and that the merged firm had a dominate position in the relevant market.

Furthermore, the anti-competitive effects created by a horizontal merger can usually be assessed separately from the generated efficiencies. When it comes to non- horizontal mergers, on the other hand, efficiencies and anti-competitive effects derive from the same source.

According to a report by RBB Economics[114] the assessment of non-horizontal mergers in such cases (tying, bundling, portfolio effects) should not be conducted in the same manner as the assessment of horizontal mergers. In the report it is argued that, in contrast to the assessment of efficiencies generated by horizontal mergers which is conducted in two separate steps (step one is to assess the likelihood of anti-competitive effects and step two is to consider whether efficiencies more than offset the anti-

[112] RBB Economics*op.cit.,* p. ii
[113] *Ibid.,*p. ii
[114] The report has been produced by RBB Economics as part of a project financed by the Commission (Enterprise and Industry Directorate_General). However the views expressed in the report, as well as the information included in it, do not necessarily reflect the opinions of the Commission and in no way commit to the institution.

competitive concerns), efficiencies generated by non- horizontal mergers in such cases must form part of a unified competitive assessment[115].

The report also suggests that where a unified assessment of efficiencies and anti-competitive effects is made, it ought to be an economic presumption that the efficiencies generated by the non-horizontal give rise to pro-competitive effects unless demonstrated otherwise[116].

5.2.1 Example of decisional practice relating to efficiency effects of non- horizontal mergers

Boeing/Hughes[117]

The case concerned a merger between Boeing Company (Boeing) and Hughes Electronics Corporation (Hughes) Boeing is a corporation operating in the field of commercial aircraft, defence and space industries, including production and launching of satellites. Hughes is a firm active in satellite-bases services and satellite manufacturing. Hughes was especially active in Hughes Space and Communication Service (HSC) which is the world leading manufacturer of GEO satellites.

The proposed transaction combined the parties' satellite manufacturing activities and resulted in vertical integration between Hughes' satellite operations and Boeing's launch activities. Boeing claimed that the proposed transaction would bring substantial synergies in terms of both intellectual capital and production.

To be able to launch a satellite, suppliers of satellites and launchers must work closely together and thus are likely to own assets that are could be used in both industries. That the merger would employ economies of scope production and intellectual capital to improve integrations seems likely. It is also plausible that the transaction would allow better coordination in research and development

Although both firms were manufacturers of satellites the Commission concluded that they were not active in the same market, as the satellite market could be broken down to separate market. Furthermore none of the parties were considered to be in a dominate position although Hughes had 35-40 % of the market. This was because there were enough countervailing buying power and alternative satellite products available.

The Commission highlighted several potential anti- competitive effects that could enable Hughes to leverage market power from GEO satellites to into the market for launchers. One concern was for example that technical

[115] *Ibid.*, p.119
[116] *Ibid.*, p.122
[117] *Boeing/Hughes* (Case IV/M. 1897) 29 October 2000, See *Ibid.*, p. 131-135

bundling would take place i.e. merged firms would produce satellites less compatible and more costly for other firms to integrate with their launchers. Another aspect that was highlighted evolved information spillovers. The Commission was concerned that the parties would use information from third parties in order to increase the sale of the other party's product[118].

Nevertheless the Commission concluded that this was not likely as Hughes did not have the power in the market for such anticompetitive behaviour to be profitable. Regarding the concerns of the spillover effects the parties undertook to establish a firewall between the launch and satellite division.

Finally, the Commission investigated claims that, in the light of current over-capacity in the launch service industry and with the launch service sector being subject to considerable fixed costs, a few won or lost launches could make a substantial difference and possibly trigger a snowball effect in which Boeing's competitors would lose additional launches as they became less cost competitive. This would weaken the rival firms' positions in the market and at the same time create or strengthen a dominate position of the merged firms.

These claims were dismissed by the Commission on the ground that the ability to make competitive bids should depend largely on marginal costs than on fixed cost and the marginal cost were considered unaffected by the transaction[119].

5.3 Efficiencies- a defence or a factor in the overall assessment of the operation?

Mergers often generate efficiencies and market power simultaneously. This may create difficulties in the assessment process in situation where a merger impedes effective competition but at the same time generate efficiencies that may counterbalance the anti- competitive effects created by the transaction[120]. Are efficiencies supposed to be assessed as a factor in the overall assessment of the merger or is it possible to invoke them as a defence counteracting the findings of impediment of effective competition?

An efficiency defence in this context means; the possibility to justify a merger that significantly impedes effective competition, by the demonstration of efficiencies likely to offset the anti-competitive effects created by the merger. In the analysis of efficiencies as a factor in the overall assessment of the operation, efficiencies are taken into account so that no impediment of effective competition may occur in the first place.

[118] *Ibid*., paras. 82
[119] *Ibid*., paras. 95-102
[120] D. Gerard. *op.cit.,* p 1369-1370

An example of a jurisdiction where they have an efficiency defence is Canada. Section 96 (1) of the Canadian Competition Act states that the Competition Tribunal shall not make an order if it finds that the merger is likely to bring about "gains in efficiency that will be greater than, and will offset, the effects of any prevention or lessening of competition that will result or is likely to result from the merger or proposed merger and that the gains in efficiency would not likely be attained if the order were made"[121].

However, the efficiency defence in Canada has long been debated, in particular after the decision of the Canadian Competition Tribunal to clear the merger between Superior Propane Inc and ICG Inc (The Superior Propane Case[122]) as the efficiency defence in section 96 of the Competition Act had been properly met. The Superior Propane Case was the first case in Canada that actually turned upon the efficiency defence and although the decision was appealed by the Canadian Competitive Commissioner the merger could prevail[123].

5.3.1 European approach

The weight and the position of efficiencies in the merger review have been hard to assess as the assessment under Old Merger Regulation did not focus much on efficiencies. Rader the assessment, in the cases where the Commission has evaluated efficiencies, was based on a weighing of pro- and anti-competitive effects of the merger with a rather strict approach not allowing the merger to impede effective competition to any degree. The issue may be considered to have been brought up under Old Merger Regulation in the *Danish Crown/Vestjyske Slagterier*[124] case.

Danish Crown/Vestjyske Slagterier

The case concerned a merger between Danish Crown, the largest Danish co-operative slaughterhouse and Vestjyske Slagterier, the second largest co-operative slaughterhouse. The notified operation involved the transformation of all activities, assets and liabilities into a newly incorporated co-operative society. Both Danish Crown and Vestjyske Slagterier were vertically integrated in slaughtering, meat processing and meat trading.

The Commission concluded that there were separate markets for the purchase of live pigs, cattle for slaughtering, fresh pork and fresh beef. Fresh pork and beef could further be subdivided into sales for industrial processors and for human consumption. It further stated that the geographic

[121] Competition Act, R.S.C.1985, c. C-34, Can be found on http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=1314&lg=e#mergers

[122] *The Commissioner of competition v. Superior Propane Inc* (2000) Comp. Trib. File no. CT1998002 (Competition tribunal)

[123] Piaskoski &Finkelstein *op.cit., p.*259

[124] *Danish Crown/Vestjyske Slagterier* (Case IV/M. 1313) 3 March, 1999

market for fresh pork sold through supermarkets and for slaughtering of live pigs was Denmark, but that the geographic market for fresh beef sold through supermarkets could be considered wider than Denmark. The definition of the geographic market for the rest of the products was left open.

In response to the Commissions findings of dominance, the parties argued that the transaction would yield efficiencies. Firstly they argued that it would generate cost savings, secondly they argued that the concentrations would achieve volumes which would make it possible for the concentration to get a direct supplier status for retailers in European Markets and thirdly they argued that the concentration would achieve volumes that would enable them to stay competing in the Japanese market.

Responding to these arguments the Commission pointed out that the Commission only takes in to account the development of technical and economic progress in so far as they are to the consumers' advantage and does not form an obstacle to competition. It further stated that "*The creation of a dominant position in the relevant markets identified above, therefore, means that the efficiencies argument put forward by the parties cannot be taken into account in the assessment of the present merger*" Finally the Commission did not consider the proposes synergy-related cost savings to be directly attributable to the merger[125].

This statement by the Commission must imply that after a dominate position in the relevant market has been identified there is no room in the Merger Regulation for an efficiency defense. Therefore efficiencies have to be assessed as a factor in the overall merger review and furthermore, as a pro-competitive effect countervailing the ant- competitive effects of the mergers. This approach can be considered to be confirmed earlier cases such as the *MSG Media Service*[126]case and the *Aérospatiale-Alenialde/ de Havilland*[127] case.

According to the Horizontal Merger Guidelines, under the New Merger Regulation, the Commission considers any substantiated efficiency claim *in the overall assessment* of the merger. This confirms that efficiencies shall be assessed as a factor in the overall merger review[128]. The Guidelines further states that the Commission may decide, "as a consequence of the efficiencies that the merger brings about, there are no grounds for declaring the merger the merger incompatible with the common market". This seems to imply that there should be some sort of balancing between the anti-competitive effects created by the merger and the efficiencies generated by

[125] *Ibid*., para. 198
[126] *MSG Media Service* (Case IV/M. 469) 9 November, 1994
[127] *Supra note* 60
[128] Horizontal Merger Guidelines, para 77

it before concluding whether or not the merger shall be considered to impede effective competition[129].

Furthermore, the merger will be considered to be compatible with the common market when the Commission will be able to conclude that "the efficiencies generated by the merger are likely to enhance the ability and incentive of the merged entity to act pro-competitively for the benefit of the consumers, thereby counteracting the adverse effects on competition which the merger might otherwise have"[130].

At first sight this might give the reader an impression that an efficiency claim may be able to be used as a defense. However, this will probably not be the case. Instead a plausible approach in this aspect is a two-step test within the overall assessment of the operation. The first step is to evaluate the anti-competitive effects created by the merger and the second step is to evaluate the generated efficiencies that counteract the anti-competitive effects. All factors are to be considered before the Commission decides whether the transaction significantly impedes competition or not. In order for the Commission to be able to clear a merger the effects of the merger must not make the consumers worse of than before merger took place.

Looking at the few precedents under the new Merger Regulation it does not seem as the Commission has evaluated efficiencies more frequently or more extensively under the New Merger Regulation than under the Old Merger Regulation. An example of a case where the Commission has recognized efficiencies under the New Merger Regulation is the case of *Procter & Gambler/ Gillette*[131].

The case involved a merger between Procter & Gambler Company (P&G) and Gillette Company (Gilllette). P&G is a global manufacturer of consumer goods, including households care, beauty care, health, baby and family care products. Gillette is a multinational manufacturer of consumer goods, including products for oral care, small electric appliances, batteries, blades and razors and personal care.

Firstly the Commission assessed the horizontal effects of the merger. Such as those that raised competition concerns about the hypothetical market for powered toothbrushes. Secondly the Commission assessed potential conglomerate effects of the merger. This because conglomerate effects might arise from the parties' significant portfolio of brands and because the parties had large market shares in many of the product markets where their activities did not overlap.

The Commission concluded, among other things, that it was unlikely that the that anticompetitive effects would be created from bundling practice as

---

[129] *Ibid.*, para 77
[130] *Ibid.*, 77
[131] *Procter & Gambler/ Gillette* (Case IV/M.3732) 15 July 2005

there was significant competition between suppliers and since there were enough buyer power countervailing the risk of portfolio effects. Furthermore the Commission stated that it had to be taken into account that "the enlarging product portfolio might bring efficiencies to the retailer and consumer…., suppliers having stronger innovation capacities, and economy of scale"[132]. This indicates that the Commission evaluated the generated efficiencies as a positive factor countervailing the anticompetitive effects that would adversely affect the market and its consumers.

At present date there are cases under the Old Merger Regulation where efficiencies may be considered to have had a significant impact for the final outcome of the decision by the Commission. However, at the time being, no case has actually fully turned upon the efficiencies. Thereof it is difficulty to make an accurate evaluation of the impact that efficiencies might have in merger assessments.

It is too early to assess the true impact of the explicit introduction of efficiencies to the New Merger Regulation and the Horizontal Merger Guidelines. Nonetheless, the introduction of efficiencies, at least in theory, must be considered to have opened up for a more extensive use of efficiencies under the EC merger control.

---

[132] *Ibid*., para. 131

6 Final remarks

In this thesis I have discussed, evaluated and analyzed the relevance of efficiencies under the EC Merger Regulation.

The new substantive criterion under the New Merger Regulation introduces an economic based approach to the merger assessment focusing on the effects of effective competition instead of the structure of the market. The new substantive criterion is the result of a long and complex debate that finally made it possible to explicitly introduce efficiencies to EC merger control.

Prior to the reform the Commission had recognized efficiencies in numerous of cases. The assessment was based on a weighing of pro- and ant-competitive effects created by the merger. Nevertheless, the Commission strictly prohibited mergers that resulted in a dominate position, irrespective of any generated efficiencies. Furthermore, the evaluations of efficiencies were never done in depth and the final outcomes of the evaluation were contradicting leaving the European market in confusion. In some cases the Commission recognized efficiencies as a positive factor, even letting them play some part to the final outcome of their decisions, while in other cases efficiencies were considered as an offence enabling the firms to increase their market power.

The debate around an efficiency "offence" must be seen as a consequence of confusion about Article 2 of the Old Merger Regulation in combination with ambiguous statements of the Commission and the CFI. There is neither anything in the Guidelines nor any case law under the New Merger Regulation that confirms the efficiency "offence" approach. Therefore it is unlikely that the Commission would reintroduce the alleged efficiency offence.

The introduction of efficiencies to the EC merger control has improved the situations considerably. The Guidelines gives a relatively clear description about requirements needed to be met in order for the Commission to take the proposed efficiencies into account and it helps to demonstrate how the Commission will assess efficiencies under the New Merger Regulation. Nevertheless, certain clarifications still need to be done; for instance there are some ambiguous terms in the Regulation that must be identified and the relationship between market shares and efficiencies should to be explained.

I also want to point out that although there are decisions under the Old Merger Regulation where efficiencies can be said to have played a role for the final outcome of the decision, no cases, at the time being, has actually turned exclusively upon efficiencies. Therefore it is difficult to find cases either under the New Merger Regulation or Old Merger Regulation that give guidance on the approach of the Commission on this matter and thus leave

the market with little knowledge of the relevance of efficiencies under EC merger control. The absence of thorough evaluation of efficiencies under the Old Merger Regulation could, on the other hand, be seen as an indication that efficiencies did not have much relevance before the New Merger Regulation came into force and that their introduction involves a great shift in the EC merger policy.

Although efficiencies finally have been introduced to EC merger control, analyzing the case law, the frequency and the extent of the assessment of efficiencies does not seem to have change considerably under the New Merger Regulation compared to under the Old Merger Regulation. Instead it seems as the current position is the result of a long evolution process in this area of the law finally forcing the Commission to introduce efficiencies to the Merger Regulation.

However, the explicit introduction of efficiencies into the EC Merger Regulation and the Horizontal Merger Guidelines should be seen, at least in theory, as strengthening efficiencies' position in the merger assessment and although it is too early to assess the approach that the Commission chooses to take in the future the introduction must be considered to have open up for a more extensive use of efficiencies in EC merger control.

When looking at the precedents under Old Merger Regulation it seems as efficiencies has been treated as a factor in the overall operation and not as a defense for an impediment of effective competition. This approach is confirmed by the Guidelines that describes what seems as a balancing approach in two steps consistent of the assessment of the created anti-competitive effects created by the merger and the counteracting pro-competitive effects i.e. generated efficiencies. Although efficiencies can be consider as some sort of "defense" as they may counteract anti- competitive effects, it does not seem as the European Union is ready to implement an efficiency defense that can intervene after a finding of impediment of effective competition.

At the date of writing this thesis many actors in the European Market wait for a decision where the Commission makes a thorough and clear evaluation of efficiencies under the New EC Merger Regulation. It is not until that decision is decided upon that the present situation can be considered completely satisfying.

Bibliography

Literature

P.Craig & De Búrca, G; *EU Law Text Cases and materials*, Oxford University Press, 3rd ed., [2003]

Habeck, M, KroÈger, F and TraÈm, M, *After the Merger, Seven Strategies for Successful Post-Merger Integration* Pearson education Limited, London, [2000]

Articles

Böge & Müller;" From the Market Dominance Test to the SLC Test: Are There any Reasons for a Change?", E.C.L.R. [2002], Vol. 23, p. 495-498.

Camesasca, P; "The Explicit Efficiency Defence in Merger Control: Does it Make the Difference" E.C.L.R., [1999], Vol. 20(1), p.14-28.

Colley, L; "From "Defence" to "Attack"? "Quantifying Efficiency Arguments in Mergers" E.C.L.R., [2004],Vol. 25(6) p.342-346.

Fountoukakos, K & Ryan, S; "A Substantive Test for EU Merger Control" E.C.L.R., [2005], Vol. 26(5), p. 277-296.

Gerard, D; "Merger Control Policy: How to Give Meaningful Consideration to Efficiency Claims?" CML. Rev.,[2003] Vol. 40(6),p.1367-1412.

Gugler, K, Mueller, D.C,Yurtoglu, B.B & Zulehner, C; "The Effects of Mergers: An International Comparison" International Journal of Industrial Organization, [2002]
Available at: http:// mailbox.univie.ac.at¨? muelled2/effects.pdf

Kiljanski, K; "Pass-on in Merger Efficiency Defence" World Competition, Vol. 26(4), [2003] p. 65-684.

Kokkoris, I; "The Reform of the European Control Merger Regulation in the Aftermath of the Airtours Case- The Eagerly Expected Debate: SLC v Dominance Test" E.C.L.R., [2005], Vol. 26(1), p.37-47.

Luescher, C; "Efficiency Considerations in European Merger Control- Just another Battleground for the European Commission, Economists and Competition Lawyers" E.C.L.R., [2004], Vol. 25(2), p. 72-86.

Maudhuit, S & Soames,T; “Change in EU Merger Control: Part 2” E.C.L.R., [2005], Vol. 26(2), p.75-82.

McDavid, J; “Proposed Reform of the EU Merger Regulation: A U.S Perspective” [2002], 17 Fall, Antitr. 52

Piaskoski, M, & Finkelstein, N;” Do Merger Efficiencies Receive” Superior” Treatment in Canada? Some Legal, Policy and Practical Observations Arising from the Canadian Superior Propane Case”, World Competition, [2004], Vol. 27(2), p. 259-298.

Schmidt, J; ”The new ECMR: ”Significant Impediment” or “Significant Improvement” CML. Rev. [2004], Vol. 41, p.1555-1582.

Voigt, S & Schmidt, A; ”Switching to Substantial Impediments of Competition (SIC) Can Have Substantial Costs- SIC” E.C.L.R., [2004], Vol. 25(9), p. 584-590.

Voigt, S & Schmidt, A; ”The Commission’s Guidelines on Horizontal Mergers: Improvement or Deterioration?” CML Rev. [2004], Vol. 41(6), p.1583-1594.

Weitbrechet,A; “EU Merger Control in 2004- An Overview” E.C.L.R., [2005], Vol. 26(2), p. 67-74.

Legislation

Regulations

Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings
(OJ L 24, 29.01.2004, p. 1)

Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings
(OJ L 395, 30.12.1989, p.1 as corrected by OJ L 257, 21.9.1990, p. 13)

Commission Regulation (EC) No 802/2004 implementing Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings
(OJ L 133, 30.04.2004, p. 1)

Non-European Legislation

Competition Act, R.S.C.1985, c. C-34, Can be found on http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=1314&lg=e#mergers

Guidelines & Commission Notices

Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings
(OJ C 31, 05.02.2004, p. 5)

Commission Notice on the concept of concentration,
(OJ C66, 02.03.1998 p.2)
(http://europa.eu.int/comm/competition/mergers/legislation/co406489_en.pdf)

Reports & Studies

European Commission Directorate-General for Economic and Financial Affairs, European Economy reports and studies, "The Efficiency Defence and the European System of Merger Control" (2001), No 5,

European Commission Directorate-General for Enterprise, De la Mano, M;"For Costumer's Sake: The Competitive Effects of Efficiencies in European Merger Control" (2002), Enterprise Paper No 11.

General Distribution O.E.C.D ./GD(96)65, Competition Policy and Efficiency Claims in Horizontal Agreements, Organization for Economic Co-operation and Development, Paris 1996

Research Institute for Industrial Economics, Röller, LH, Stennek, J & Verboven, F; "Efficiency gains from mergers". (2000), Working paper No.543.

RBB Economics report, European Commission Directorate-General for Enterprise and Industry, Bishop, S, Lofaro, A, Rosati, F, Young, J; "The Efficiency- Enhancing Effects of Non- Horizontal Mergers", European Communities (2005)

Trichy, G. (2001) "What Do We Know About The Success and Failure of Mergers" Journal of Industry Competition and Trade, 1(4) p. 347-394.

Speeches

Monti, M, European Commissioner for Competition Policy; *The Future of Competition Policy in The European Union,* Speech at the Merchant Taylor's Hall. 9 July 2001

Monti, M, European Commissioner for Competition Policy;" *Roadmap for the reform project*", Conference on the Reform of European Merger Control, British Chamber of Commerce, Brussels, (4 June 2002)

Monti, M, European Commissioner for Competition Policy, "*Merger control in the European Union: a Radical Reform*", European Commission/IBA Conference on EU Merger Control, Brussels, (7 November 2002.)

Press releases

IP/04/70 "EU gives itself new merger control rules for 21st century" 20/01/2004

Table of Cases

ABB/Daimler-Benz (Case IV/M 580), 18 October, 1995,
(Celex Document No: 31997D0025) (OJ L11, 14.01.1997 p.1)

Accor/Wagon Lits (Case IV/M 126), 28 April, 1992,
(Celex Document No: 31992D0385) (O J L 204, 21.07.1992 p.1)

Aérospatiale-Alenialde/ de Havilland (Case IV/M.053) October 2, 1991
(Celex Document No. 31991D0619) (OJ L334 05.12.1991 p.42)

Air tours v. Commission (Case T-342/99) 6 June, 2000
(Celex Document No. 61999B0342) (ECR 2004 p.0)

Alcatel/Telettr (Case IV/M. 042) 4 April 1991
(Celex Document No. 31991D0251) (OJ L122, 17.05.1991 p.48)

AT&T/NCR (Case IV/M.05) 18 January 1991
(OJ C16 24.01.1991 p.0)

Boeing/Hughes (Case IV/M. 1897) 29 October 2000
(Celex Document No. 32004D0195) (OJ L 063 28.02.2004 p.53)

Danish Crown/Vestjyske Slagterier (Case IV/M. 1313) 3 March 1999
(Celex Document No. 32000D0042) (OJ L 020, 25.01.2000 p.1)

General Electric/ Honeywell (Case COMP/M. 2220), 3 July 2001
(Celex Document No. 32004D0134) (OJ. L48, 18.02.2004 p1)

Mercedes/Benz/Kässbohrer, (Cases IV/M.477) 14 February1995,
(Celex Document No. 31995D0354) (OJ L 211, 06.09.1995 p.1)

Procter & Gambler/ Gillette (Case IV/M.3732) 15 July 2005
(Celex Document No. 32005M3732)

Procter & Gambler/ Schickedanz (Case IV/M .430), 21 June 1994
(Celex Document No. 31994D0893) (OJ L 354, 31.12.1994 p.32)

M*annesmann/Valourec/Ilva* (Case IV/M. 315) 31 January 1994
(Celex Document No. 31994D0208) (OJ L102 1994 p.15)

MSG Media Service (Case IV/M. 469) 9 November 1994
(Celex Document No. 31994D0922) (OJ L 364, 31.12.1994 p.1)

Nordic Satellite Distribution (Case IV/M. 490) 19 July 1995
(Celex Document No. 31996D0177) (OJ L 053, 02.03.1996 p. 20)

Saint-Gobain/Wacker-Chemie/NOM, (Case IV/M. 774), 4 December 1996 (Celex Document No. 31997D0610) (O J L 24 , 10.09.1997 p.1)

Schneider Electric SA v. *Commission*, (Case T-310/0), 22 October 2002 (Celex Document No. 62001A0310) [2002] ECR II-4071

Tetra Laval BV v. *Commission*, (Case T-5/02) 25 October 2002
(Celex Document No. 62002A0005) [2002] ECR II-4381

Tetra Laval/Sidel (Case COMP//M 2416), 30 October 2001
(Celex Document No. 32004D0124) (OJ L 043, 13.02.2004 p.13)

Vivendi/Canal+/Seagram (Case COM/P 2050) 13 October 2000
(Celex Document No. 32000M2050) (OJ C 311, 31.10.2000 p.3)

Non-European Cases

The Commissioner of competition v. Superior Propane Inc (2000) Comp. Trib. File no. CT1998002 (Competition tribunal)