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Efficiencies in EU merger control

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Outline of presentation

Efficiencies in EU merger control

- Concept and importance of efficiencies
- History of efficiencies in EU merger control
- Current legal framework
- Criteria for taking efficiencies into account
- Burden and standard of proof
- Efficiencies in the Commission's practice
- Concluding remarks

Concept and importance of efficiencies

What are efficiencies and why are they important for merger control?

- Efficiencies mainly refer to economic gains (e.g. lower production costs) but can also encompass other benefits (e.g. innovation)
- Efficiency gains (“efficiencies”) brought about by mergers should be seen as positive effects of a merger; when taken into account they can counterbalance any adverse effects found
- Analysis of a merger should not be one-sided – anti and pro-competitive effects of a merger must be analysed comprehensively
- Efficiencies need to be seen in the context of the legal test for merger control (consumer welfare standard / total welfare standard etc), in their procedural context and as part of an overall strategy for analysing a merger

History of efficiencies under the ECMR

Regulation 4064/89

- Article 2(1)(b)
- No clear framework for efficiencies and no guidelines
- Commission decisions did, however, look into “technical and economic progress” arguments
- Efficiency arguments never accepted
- Commission accused of using efficiencies against the parties (“efficiency offence”)
- See some relevant cases before 2004:
 - *M. 53 Aerospatiale / de Havilland* (not clear that efficiency defence available; in any event, efficiencies not substantial; not merger-specific)
 - *M.993 Bertelsmann/Kirch/Premier* (digital TV improvements / no consumer benefit)
 - *M. 1313 Danish Crown / Vestjyske Slagterier* (efficiency defence not available in presence of dominance; in any event, efficiencies not merger-specific)
 - *M.2220 GE/Honeywell* (efficiency offence?)
- The 2004 reform – greater recognition of efficiencies

Current legal framework

The relevant legal instruments

- Regulation 139/2004 (the EC Merger Regulation)
 - Article 2(1)b
 - Recital 29
- Implementing Regulation – Form CO
- Horizontal Merger Guidelines
- Non-Horizontal Merger Guidelines
- Case law?

Legal test and type of assessment

- Legal test under ECMR is SIEC (Article 2.2 and 2.3 ECMR)
- Consumer welfare standard used by the Commission
- Legal basis for efficiencies: Article 2(1)b ECMR
 - Subordinates/includes efficiencies assessment to the competition test
 - Overall assessment of the merger including efficiencies to conclude whether or not SIEC
- Conceptually this is not a “proper” defence (unlike e.g. in Canada)

Conditions for efficiencies

Horizontal Merger Guidelines

1. Substantial, timely, likely to benefit consumers (pass-on requirement)

- Benchmark: consumers not to be worse off as a result of the merger
- No trade-offs between markets (in principle)
- Types of efficiencies
 - Static and dynamic efficiencies
 - Cost reductions (marginal or variable cost reductions preferred to fixed cost reductions)
 - Savings in production or distribution
 - Economies of scale and scope
 - General corporate efficiencies
 - Improved products or services, R&D, innovation
- Substantial and timely benefits
 - Sliding scale: the greater the anti-competitive effects / the more efficiencies must be substantial, timely and likely to benefit consumers

Conditions for efficiencies (cont.)

Horizontal Merger Guidelines

2. Merger specific

- Direct consequence of the merger
- Cannot be realistically achieved to a similar extent through less anti-competitive alternatives, e.g. licensing agreement or production joint venture
- Alternatives which are “reasonably practical”

3. Verifiable

- Evaluation of the claimed efficiencies
- Evidence, quantification and standard / burden of proof

Burden and standard of proof

Horizontal Merger Guidelines

•Burden

- Asymmetry of information
- Notifying parties bear the burden of providing necessary information
- According to the Commission, parties also bear burden of showing efficiencies counteract adverse effects on competition and benefit consumer
- Is this latter point correct in law?

•Standard of proof (verifiability)

- “Reasonable certainty” that efficiencies “likely” to materialise
- Substantial enough to counteract anti-competitive effects
- Whenever possible efficiencies should be quantified
- If no data is available, it must still be possible to foresee a clearly identifiable consumer benefit
- The longer term the less likely to materialise

Burden and standard of proof (cont.)

Evidence

- Internal documents
- Investor presentations
- Historical examples
- Pre-merger external expert reports
- Account statements
- Economic analysis and submissions
- Other evidence that proves efficiencies and consumer benefits

Submitting efficiency arguments

Section 9 Form CO

- Voluntary submission
- Description of efficiencies
- Detailed explanation as to how and when to be achieved
- Quantification
- Pass-on
- Merger specificity

DG Competition Best Practice Guidelines

- Present evidence as early as possible
- Pre-notification stage
- Extensive analysis may be required

Strategic considerations

- Strategy in considering and presenting arguments, gathering evidence, quantifying efficiencies and time of submitting arguments/evidence

Efficiencies in non-horizontal mergers

Non-horizontal merger guidelines

- More likely and substantial scope for efficiencies in NHM
 - Complementary products
 - Internalisation of double mark-ups
 - Decrease in transaction costs
 - Better coordination of production and distribution process
 - “Cournot effect”, economies of scope (in conglomerate mergers)
- Conditions same as for HM
- Efficiencies and effects on competition, however, more intermingled in NHM (need for overall assessment rather than two step approach is greater)

Example of Commission practice (1)

M.4439 Ryanair / Aer Lingus (efficiencies rejected – merger prohibited)

Starting assumption

- No “efficiency defence” but weighing of pro- and anti-competitive effects

Verifiability

- Unverifiable assumptions
- No objective or convincing evidence
- Assumptions contradicted by past practice e.g. Buzz takeover

Merger specificity

- Some efficiencies could occur regardless of the merger e.g. fuel and staff costs
- Sufficient incentive to remain an efficient operator in absence of the merger
- Efficiencies to affect fixed rather than marginal costs

Benefit to consumers

- Fixed cost savings less likely to be passed on to consumers
- Consumer benefit dependent on a chain of events
- High market shares unlikely to result in consumer benefit
- Sliding scale approach

Example of Commission practice (2)

M.4057 Korsnäs / Assidomän Cartonboard

- **Efficiencies accepted as one of several factors for clearance in Phase I**

- Efficiencies were substantial
 - Input costs, reduction in personnel, production efficiencies
 - 0-5% of merged entities' net sales
 - R&D efficiencies
 - Broader portfolio – better production allocation across sites
- Some types of efficiencies not possible to evaluate in Phase but some production efficiencies were verifiable
- Production efficiencies were timely and likely to benefit consumers
 - Evidence: specific contract in existence with merged parties' biggest customer
- Merger specificity not clearly addressed

Further examples: some relevant Commission decisions (after 2004)

Cases in which efficiency claims were accepted (NB: treated, however, as one of several factors for clearance, i.e. not really a “defence”)

M.3664	Repsol Butanol / Shell Gas
M.3732	Procter & Gamble / Gillette
M.3886	Aster 2 / Flint Ink
M.3998	Axalto / Gemplus
M.4057	Korsnäs / Assidoman Cartonboard
M.4854	TomTom / Tele-Atlas
M.4942	Nokia / Navteq

Cases in which efficiency claims were rejected

M.3099	Areva / Urenco / ETC JV (Ph II - cleared with remedies)
M.4000	Inco / Falconbridge (Ph II - cleared with remedies)
M.4439	Ryanair / Aer Lingus (Ph II - prohibited)
M.5141	KLM / Martinair (Ph II - cleared)

Concluding remarks

- EU merger control now has a specific legal framework for assessment of efficiencies
- Commission is more open to considering efficiencies and slowly a body of Commission decisions with specific and more sophisticated analysis of efficiencies is emerging
- Conditions are, however, difficult to meet in practice
- Difficult (impossible?) to use efficiency “defence” successfully in cases which present significant anti-competitive effects absent the efficiencies
- But efficiencies can cement decision to clear alongside other factors
- Strategy important – consider efficiencies and best way to present them from the outset