Merger Efficiencies: A practitioner’s view

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Brief History

A controversial debate

- The role that efficiencies should play in merger control has been one of the most controversial debates
- The efficiencies test is intrinsically linked to the question of what should be the appropriate welfare standard for competition enforcement
- Even before the adoption of the original ECMR, there was a debate as to whether the ECMR should include a "balancing test" between the basic objectives of the Treaty vs. the harm to competition
- The EC has made the clear choice to focus exclusively on a consumer welfare standard, to the exclusion of other considerations
- Today the EC is largely aligned with the US. Canada is viewed as a more "efficiency-friendly" jurisdiction given that they adopt a "total welfare standard" (Superior Propane)
- The rise of protectionism might reopen the debate over an adjustment of the consumer welfare standard and ultimately the role that efficiencies should play

Efficiencies under the old ECMR

- Under the old ECMR (dominance standard), the EC's official position was that efficiencies could not offset anticompetitive effects
  - Balancing test of anticompetitive effects vs. Treaty objectives taken out from ECMR
  - "efficiencies were assumed for all mergers up to the limit of dominance" (Roller/Neven: if efficiencies were not taken into account all horizontal mergers would be prohibited)
- Practitioners stayed away from efficiencies because of the "efficiency offence" concerns – *i.e.* arguments put forward to support efficiency claims would be used against them
- This was in contrast to the U.S., which recognized efficiencies in borderline cases
  - Difference with the U.S. was explained - at least in part - by different enforcement focus (U.S. focused more on coordinated effects while EC focused on single firm dominance)

Efficiencies under the new EUMR

- Revised EUMR (2004) and Horizontal/Non-Horizontal Merger Guidelines recognised a role for efficiencies (while at the same time increasing the scope of the substantive test)
  - Greater role for efficiencies explicitly acknowledged for non horizontal mergers
  - Efficiencies test under EUMR is largely aligned with the U.S.
- There is still a reluctance to rely on them because (i) the test is too strict and requires a lot of evidence; (ii) the data could still be used against the merging parties; and (iii) it might signal - according to some people - the case is weak and could evidence increased market power
- The recent emergence of new and more “qualitative” theories of harm, such as the innovation theory of harm, begs the question of whether the efficiencies defence should be expanded accordingly
- Asymmetry between more “qualitative” theories of harm (e.g. effects on innovation) and the lack of any possibility to claim “qualitative” efficiencies that are hard to quantify

Efficiencies: The Legal Test

Efficiencies: Legal Test

Efficiencies: Three cumulative conditions	
Benefit consumers	• Cost or revenue synergies that are publicly announced in major deals are not automatically efficiencies • Marginal costs are viewed as more likely to be passed on (vs fixed costs) • Debate of what is variable vs. fixed cost (e.g. investments in 5G infrastructure) • The burden is on the parties to show that the efficiencies will be passed on
Merger specific	• There should be no less restrictive ways to achieve the same efficiencies (e.g. cooperative arrangement or network sharing arrangements)
Verifiable	• It must be reasonably certain that the efficiencies will materialise, and be substantial enough to counteract the potential harm to consumers

Static vs. Dynamic efficiencies

Static efficiencies	Dynamic efficiencies
Static efficiencies: one-off improvements in production abilities of merging parties that will typically result in marginal cost reductions. Measurable at a specific point in time.	Dynamic efficiencies give rise to improvements in the growth of production possibilities (e.g. new technology, increases in productivity). Realised over the longer term.
Examples include - Economies of scale - In-sourcing - Elimination of double marginalisation - Improved production control methods	Examples include - Fixed cost reductions - Access to financial resources - Investment in next generation networks - Ability/incentives to carry out R&D - Quality - Combination of complimentary operations (e.g. marketing and distribution activities)

- EC will typically only accept static efficiency claims, and only when the three conditions (merger specificity, verifiability, pass-on) are met.
- Often big debate among economists over what is a fixed vs. marginal cost.
- Some asymmetry between broadening theories of harm (non-coordinated effects in telco, innovation theory of harm) and limited scope to argue for dynamic efficiencies.

Efficiencies: Legal Test – Practical issues

- There are also very concrete hurdles in terms of claiming efficiencies:
  - Section 9 of the Form CO requires concrete documentary evidence that the efficiencies are substantial, verifiable and will benefit consumers
  - The EC will go beyond the documents submitted by the parties and look for "ordinary course of business" documents
    - not uncommon to produce hundreds of thousands of documents in high profile cases
    - third party consultant/economist documents created during the merger review will be viewed with relative scepticism (more focus given to ordinary course of business documents)
  - Information exchange/gun jumping constraints means that meaningful calculation of efficiencies would require clean teams
  - Need to adjust efficiency claims to factor in the impact of remedies

Efficiencies as part of competitive assessment

- Given the stringent legal test, there have been attempts to present efficiencies as an integral part of the competitive assessment of the merger and not as a separate defence.

Leading cases where efficiencies assessment was integrated into merger assessment **Common denominator: compelling counterfactual**	
MSFT/Yahoo! Search Business M.5727 M.5727 18 February 2010	• MSFT argued that the merger would enable the MSFT to gain scale and compete more effectively against Google, compete more effectively against Google, benefiting both users and advertisers. advertisers. • The EC largely agreed with the Parties' arguments, and relied heavily on a counterfactual (not efficiencies) analysis. counterfactual (not efficiencies) analysis.
Nynas/Shell/Harburg Refinery M.6360 M.6360 2 September 2013	The EC carried out a proper efficiency analysis that was integrated into the competitive assessment competitive assessment • the capacity increase was verifiable and there were no less restrictive alternatives, given that the plant would alternatives, given that the plant would otherwise exit the market; • efficiencies would be passed on, as Nynas could substitute third party supply with cheaper EEA products, supply with cheaper EEA products, thereby lowering variable costs; and • absent the merger the Nynas organisation would be significantly reduced and would have less incentives and and would have less incentives and ability to compete.

Efficiencies: Recent Cases

Recent Phase II cases

Case	Efficiency Claims Made	EC assessment
Qualcomm/NXP M.8306 18 January 2018	No efficiency claims made	N/a
Chemchina/Syngenta M.7962 5 April 2017	No efficiency claims made	N/a
Dow/Dupont M.7932 27 March 2017	Parties made several efficiency claims: (i) internalisation of the effects of spillovers (reduced innovation costs); (ii) increase return to innovation; (iii) allow combined firm to capture greater value of its innovation by combining it with complementary products offered by the other party; (iv) elimination of redundant assets; and (v) combination of complementary strengths. Parties claimed that the first three (i)-(iii) should not be assessed as "merger specific efficiency" but should be considered in the overall innovation effects SIEC assessment (para. 3275)	Rejected the request that the first three efficiencies be considered as part of the innovation effects assessment EC found that these arguments are not "merger specific" or linked to the elimination of competition between the parties Synergies/cost-savings in R&D would reduce ability of combined firm to compete in innovation and are therefore not efficiencies that could benefit consumers

Recent Phase II cases

Case	Efficiency Claims Made	EC assessment
Wabtec/Faiveley Transport M.7801 4 October 2016	No efficiency claims made	N/a
Hutchinson 3G Italy/Wind/JV M.7758 1 September 2016	Parties claimed: (i) cost and revenue synergies, with variable and fixed components; and (ii) the creation of a third high-quality network (comparable to Tim and Vodafone).	The parties failed to demonstrate that the efficiencies were merger specific, likely to materialise and able to counter the anti-competitive effects on competition that the Commission considers might otherwise result from the Transaction.
ASL/Arianespace M.7724 20 July 2016	Parties claimed: (i) various efficiencies due to vertical integration; (ii) synergies between distribution and commercial networks; and (iii) allow the development of new programmes.	The parties' claims were not sufficiently substantiated with evidence

Recent Phase II cases

Case	Efficiency Claims Made	EC assessment
Liberty Global/BASE Belgium M.7637 4 February 2016	No efficiency claims made	N/a
FedEx/TNT Express M.7630 8 January 2016	Parties claimed: (i) cost savings due to larger and more efficient delivery networks; and (ii) cost savings due to economies of scale in air network operations.	Accepted by the Commission.
GE/Alstom M.7278 8 September 2015	Parties claimed: (i) direct sourcing savings; (ii) double-marginalisation efficiencies; (iii) lower materials costs; and (iv) additional cost savings due to sourcing and manufacturing.	Efficiencies were accepted (despite some reservations on the verifiability of (iv)) but were deemed not to be sufficient to offset the harm to consumers associated with the transaction