ROUNDTABLE ON THE ROLE OF EFFICIENCY CLAIMS IN ANTITRUST PROCEEDINGS

-- Note by the Delegation of the European Union --

This note is submitted by the delegation of the European Union to the Competition Committee FOR DISCUSSION under Item XII at its forthcoming meeting to be held on 24-25 October 2012.
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1. Introduction

1. In its competition analysis in antitrust and mergers cases, the European Commission ('Commission') generally applies an approach which endeavours to assess the effects an agreement, unilateral conduct or a concentration has on competition and consumer welfare. Such an approach entails the identification of the potential anti-competitive effects on parameters of competition such as price, quantity, product quality and variety, and innovation, as well as the pro-competitive effects, notably efficiencies. The analysis of efficiencies can play a role both in antitrust and mergers cases assessed by the Commission.

2. In the area of antitrust, Article 101 of the Treaty on the Functioning of the European Union ('TFEU') specifically foresees that an agreement which has an anti-competitive object or effect may nevertheless be unproblematic from a competition point of view where the agreement contributes to improving the production or distribution of products or to promoting technical or economic progress, that is to say where the agreement gives rise to efficiencies – provided, inter alia, that those efficiencies offset the restriction of competition the agreement would likely bring about.

3. Even though the wording of Article 102 TFEU, which prohibits abuses of a dominant position, does not contain an efficiency defence, the Court of Justice of the European Union has recently confirmed that dominant companies have the opportunity to advance efficiency arguments in order to justify conduct which may otherwise be regarded as abusive.1

4. Pro-competitive effects are also one of the aspects considered in EU merger control and the potential for mergers to give rise to efficiencies is foreseen in the legislative bases for merger control at the EU level. When analysing whether a merger would significantly impede effective competition, the Commission performs an overall competitive assessment in which various factors can be taken into account, including the development of technical and economic progress, i.e., efficiencies – provided that they benefit consumers and do not form an obstacle to competition.2 This means that in the overall assessment whether a proposed concentration gives rise to a significant impediment to effective competition, efficiencies are an important factor of the assessment, on the basis of which intervention against a merger may ultimately not be warranted. However, the conditions for taking efficiencies into account are strict and well-defined in the Commission's merger guidelines.

5. Guidance from the Commission on the treatment of efficiencies in antitrust and merger cases is set out in various guidelines and notices. To name but a few: for example, the General Guidelines

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1 Case C-209/10 Post Danmark [2012] ECR I-not yet reported, paragraphs 41 et seq.
concerning agreements\(^3\) describe the different types of efficiencies that may play a role in antitrust cases and the criteria those efficiencies must fulfil in order to be relevant; the Horizontal Guidelines\(^4\) set out the kind of efficiencies that different types of cooperation agreements between competitors, such as research and development or joint production agreements, may give rise to; the Commission's Guidance Paper on Article 102 TFEU\(^5\) also contains information on the efficiencies that certain types of potentially abusive conduct can bring about; and, the Commission's Horizontal Merger Guidelines\(^6\) and Non-Horizontal Merger Guidelines\(^7\) explain how the Commission will deal with efficiency arguments in merger proceedings. These documents are not only internal guidelines for the Commission's staff, they are also intended to help companies self-assess whether their agreements, unilateral practices or mergers are, or would be, in compliance with EU competition law on the basis of efficiencies.

6. In the field of antitrust, since the overhaul of the procedural regime for the application of EU competition law in 2004, the Commission has not "cleared", by decision, agreements (or unilateral practices) based on efficiencies that offset competitive harm. In case anti-competitive effects of an agreement or unilateral practice were offset by efficiencies, the Commission would simply not bring a case or close a case that had already been opened. This does not require a reasoned decision which would set out in detail the efficiencies analysis that has prompted the closure of the case. However, the Commission has in the recent past made antitrust prohibition decisions that have discarded the efficiency claims made by the parties.\(^8\)

7. Given that the Commission needs to adopt reasoned decisions at the end of merger investigations and that a non-confidential versions of these decisions are published, the case practice of the Commission with regard to efficiencies is transparent.\(^9\) Regardless of whether any pro-competitive effects claimed by the merging parties are ultimately acknowledged by the Commission or not, the Commission's decision will normally include an assessment of the issue. This is at least the case for those mergers where the merging parties make an "efficiency defence", meaning that the parties argue that a competition problem preliminarily identified by the Commission would be counteracted by the merger's pro-competitive effects of a merger.

8. To date the Commission has in a number of merger cases acknowledged the potential for pro-competitive effects to satisfy the necessary conditions under EU merger control. These cases primarily concern non-horizontal merger cases, but also include horizontal mergers. At the same time, the Commission has so not identified a horizontal merger where the harm would have been counteracted or even outweighed by pro-competitive effects.

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\(^9\) See, for example, Cases COMP/M.6166 – Deutsche Börse/NYSE Euronext or COMP/M.4439 – Ryanair/Aer Lingus I.
9. By way of final introductory remark, in particular in the context of EU merger control, it should be underlined that the business term "synergies", which is often used in the context of proposed mergers, does not necessarily encompass the same effects as the concept of efficiencies in the competition policy context. There can be overlaps between the two categories of effects, but the pro-competitive effects that are eligible as "efficiencies" under competition policy need to fulfil certain cumulative conditions.

2. Taxonomy of efficiency claims and the scope for considering efficiencies under different areas of competition law

10. In principle, all objective economic efficiencies can be acceptable in EU antitrust and merger proceedings, irrespective of the terminology used to describe them. Hence, acceptable efficiencies include "static and dynamic" efficiencies, "allocative, productive and dynamic efficiencies" or "cost and qualitative" efficiencies. Such efficiencies may, for example in the context of a joint production agreement, be cost savings, better production technologies or increased product variety. A research and development agreement that combines complimentary skills and assets may result in improved or new products and technologies being developed and marketed more rapidly.

11. Whereas the fact that it may require some time for dynamic efficiencies to materialise does not in principle stand in the way of their acceptance, the Commission takes the view that the greater the time lag, the greater must be the efficiencies to compensate also for the loss to consumers during the period preceding their generation. In addition, it should be noted that the value of a gain accruing to consumers in the future may not be the same as a present gain.10

12. Mergers may also bring about various types of efficiency gains that can lead to lower prices or other benefits to consumers. Of particular relevance could be cost savings that lead to a reduction of variable or marginal costs. Another example of efficiencies could be new or improved products developed and marketed by a joint venture that also pools its parents' research and development activities.

13. The Commission has faced numerous kinds of efficiency claims in merger cases. A main distinction could be made between horizontal and non-horizontal mergers. In horizontal cases, the Commission most often faces claims of economies of scale and scope such as in production or distribution. In certain industries claims also include pro-competitive network effects. Furthermore, innovation as a function of research and development is mentioned frequently. Claims can also include other aspects such as reputation, trust or ability to serve specific demand. In non-horizontal merger cases, the Commission frequently faces arguments concerning the internalisation of externalities, that is to say the elimination of double-marginalisation in vertical mergers or conglomerate mergers involving complementary products. Ultimately, any claims of pro-competitive effects are always industry- and case-specific.

14. The Commission's merger guidelines set out the general framework for the analysis of efficiencies in a pragmatic way. They do not define the terms "static" or "dynamic" efficiencies or any other related terms such as "allocative" or "productive" efficiencies. Nor do the guidelines articulate a preference for any type of efficiencies over another. They do however indicate that marginal cost savings are more likely to meet the necessary conditions than fixed cost savings due to the higher likelihood of being passed on to consumers. This is approach is in line with the Commission applying a consumer welfare standard in its merger assessment.

15. Dynamic efficiencies are more difficult for the Commission to take into account in merger cases in particular due to their timing. The Horizontal Merger Guidelines explain that, in general, the later the efficiencies are expected to materialise in the future, the less weight the Commission can assign to them.11

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10 General Guidelines, paragraphs 87 and 88.
11 Horizontal Merger Guidelines, paragraph 83.
The fact that dynamic efficiencies may be expected to take longer time to materialise than static efficiencies and are therefore inherently more uncertain may therefore – despite the fact that merger control is a prospective analysis – reduce the importance the Commission can give them in a merger case. However, this also reflects the typical time horizon for the Commission's assessment of a merger's impact.

3. Assessing efficiency claims

16. The criteria applied for assessing efficiency claims in antitrust investigations are similar irrespective of whether the analysis takes place in the context of the investigation of an agreement or a unilateral practice.

17. With regard to agreements, the relevant criteria are described in the Commission's General Guidelines.\textsuperscript{12} Notably, all efficiency claims must be substantiated by the party that wishes to rely on them so that the Commission can verify: the nature of the claimed efficiencies; the causal link between the agreement and the efficiencies; the likelihood and magnitude of each of the claimed efficiencies; and how and when each of the claimed efficiencies would be achieved. In addition, the restrictions of competition generated by the agreement must be indispensable to attaining the efficiencies. Moreover, consumers must receive a fair share of the efficiencies and the agreement must not lead to the elimination of competition. If all those criteria are fulfilled, it can be concluded that the efficiencies created by an agreement offset its restrictive effects on competition.

18. To succeed with an efficiency defence in the context of unilateral conduct, a dominant company would need to show that: the efficiency gains that are likely to result from the potentially abusive conduct offset any likely negative effects on competition and consumer welfare generated by that conduct; those efficiency gains have been, or are likely to be brought about as a result of the potentially abusive conduct; the potentially abusive conduct is necessary for the achievements of those efficiency gains; and the potentially abusive conduct does not eliminate effective competition by removing all or most existing sources of actual or potential competition.\textsuperscript{13}

19. In order to be taken into account in an antitrust investigation by the Commission, efficiency claims must be substantiated so that they can be verified. To this end, parties must bring forward convincing arguments and evidence. To this end, they can submit qualitative and/or quantitative evidence. For example, in the case of cost efficiencies, parties must as accurately as reasonably possible calculate or estimate the value of those efficiencies and describe in detail how they have computed the amount. They must also describe the method(s) by which the efficiencies have been or will be achieved. The data submitted by the parties must be verifiable so that there can be a sufficient degree of certainty that the efficiencies have materialised or are likely to materialise in the future. If qualitative efficiencies such as new or improved products or other non-cost based efficiencies are claimed, the nature of those efficiencies and how and why they constitute an objective economic benefit must be described and explained in detail. Where an agreement has not yet been implemented and, consequently, efficiencies are yet to be attained, the parties must substantiate any projections as to the date from which the efficiencies will become operational.

20. As regards non-horizontal mergers, the Commission's Non-Horizontal Merger Guidelines acknowledge that "vertical and conglomerate mergers provide substantial scope for efficiencies".\textsuperscript{14} Indeed, in non-horizontal mergers for example their potential for eliminating double-marginalisation is directly taken into account when analysing the merging parties' incentives to foreclose and the effects of the

\textsuperscript{12} General Guidelines, paragraphs 51 et seq.

\textsuperscript{13} Case C-209/10 \textit{Post Danmark} [2012] ECR I-not yet reported, paragraph 42.

\textsuperscript{14} Non-Horizontal Merger Guidelines, paragraph 13.
notified merger on downstream markets. The specific conditions for dealing with efficiencies stemming from horizontal mergers in the context of an EU merger control assessment are defined in the Horizontal Merger Guidelines.

21. The most important conditions for efficiencies to be eligible in a merger investigation are defined in detail for horizontal merger cases: efficiencies need to be merger-specific, verifiable and benefit consumers. In other words, the efficiencies need to be a direct consequence of the merger and cannot be achieved by less harmful alternatives; they need to be foreseeable and substantial, which in practice is often illustrated by quantifying them; finally, the benefit to consumers requires that any substantial and timely efficiencies would be passed-on to consumers in the form of price reductions or improvements of non-price parameters. In Deutsche Börse/NYSE Euronext, the Commission accepted that the proposed merger would have likely generated efficiencies but found that those efficiencies would not be enough to outweigh the competitive harm the merger would have given rise to.

22. In order to demonstrate efficiencies in a merger case, the most promising sources of evidence include internal documents of the merging parties, in particular those which their management used to take decisions when preparing the merger. Moreover, historical examples of efficiencies with consumer benefit as well as external studies on the efficiency gains prepared before the merger are relevant. Finally, statements from management to owners and financial markets may also be considered informative.

23. Both in the fields of antitrust and mergers, the Commission will in principle only take account of those efficiencies that offset the harm suffered by the consumer groups that are adversely affected by the restrictive agreement, unilateral practice or merger. This means that in principle it will be efficiencies generated in the market in which the competitive harm occurs that can be relied upon to offset that harm.

4. Procedural issues

24. In antitrust cases, the Commission follows a "staggered approach" when analysing the anti-competitive effects and the efficiencies that an agreement or a unilateral practice may generate. This is mirrored by the allocation of the burden of proof. While the Commission has the burden of proof for showing a restriction of competition under Article 101 TFEU or an abuse of a dominant position under Article 102 TFEU, the burden of proof for demonstrating efficiencies rests on the parties that invoke them in defence. This rule is enshrined in the European regulation governing antitrust procedures and has recently been confirmed by the Court of Justice of the European Union with regard to efficiencies claimed in the context of investigations concerning the abuse of a dominant position.

25. Such an allocation of the burden of proof is justified as the information required to assess the claimed efficiencies is usually exclusively held by the parties. Consequently, it is incumbent on them to provide the relevant information to allow the Commission to assess whether or not there will be efficiencies. Not doing so will mean that the Commission is not in a position to include an efficiencies

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15 See, for example, Cases COMP/M.4854 – TomTom/Tele Atlas or COMP/M.4942 – Nokia/Navteq.
16 Horizontal Merger Guidelines, paragraphs 76 et seq.
17 Case COMP/M.6166.
18 Horizontal Merger Guidelines, paragraph 88.
19 See Horizontal Merger Guidelines, paragraph 79; General Guidelines, paragraph 43.
21 Case C-209/10 Post Danmark [2012] ECR I-not yet reported, paragraph 42.
analysis in its assessment. Consequently, the parties bear the responsibility for any potentially ensuing adverse effects on consumer welfare that their inaction may give rise to. Where a party has provided substantiated evidence concerning efficiencies, the Commission must examine that evidence and cannot simply discard the arguments made without explanation or justification. If the Commission is not satisfied with substantiated efficiency claims it must refute those claims and provide reasons for its position. Otherwise, the burden of proof borne by the party making the efficiency claims is considered to be discharged.

26. In merger cases essentially the same principles apply. Given that the merging parties are in possession of most information relevant for the assessment of efficiencies in mergers, it is under EU merger control incumbent upon the parties to claim the efficiencies and to provide in due time the information to assess whether the claimed pro-competitive effects meet the necessary conditions. This does not mean that the Commission does not customarily take into account relevant information obtained during an investigation from other market participants such as competitors. However, the parties are the primary source of relevant information. This seems entirely appropriate given that the parties are normally striving for approval of the merger and hence have an incentive to provide the relevant information on efficiencies.

27. As to the steps taken in the assessment, in non-horizontal mergers the analysis of efficiencies, notably the possible elimination of double-marginalisation, is directly factored into the assessment of whether the merging parties will have an incentive to foreclose post-merger and of the effects of the merger on downstream markets. For horizontal mergers, the Commission may initially follow a sequential approach whereby it first identifies the potential competitive harm and then addresses the question of efficiencies. However, ultimately the Commission needs to conduct an overall assessment and reach a conclusion on whether a merger is more likely than not to give rise to a significant impediment of effective competition. This of course includes both the harmful and possible pro-competitive effects. The precise path to reaching a conclusion is of reduced importance given that Commission ultimately needs to take a decision on the basis of a merger's overall impact in a market.

5. **Ex-post assessment of efficiency claims**

28. To date the Commission has not carried out an ex-post assessment of efficiencies that were claimed by the parties under investigation in an antitrust case. Nor has the Commission carried out an ex-post assessment of efficiencies claimed during merger investigations.

29. The Commission has conducted an ex-post assessment of its merger policy in the past. This has led, for example, to the 2004 revision of the EU Merger Regulation and to a comprehensive review of the Commission's remedies policy in merger cases. Given that the Commission has so far not yet approved a horizontal merger case on the basis that the merger-specific efficiencies would offset or even outweigh the merger-specific harm, there does not currently seem to be a meaningful basis for an ex-post assessment of efficiencies in merger cases.

6. **Conclusion**

30. Under EU competition law, efficiencies are an integral part of the competition assessment both under antitrust and merger rules. The principles for the assessment of efficiencies in these two areas are largely the same and based on sound economics. Clear procedural provisions govern the way parties under investigation can claim efficiencies. These procedural provisions underline that the responsibility for raising and substantiating pro-competitive effects lies with the companies under investigation.