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European champions and competition enforcement

Is DG COMP in ideological denial?

By

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1. Introduction

According to Commissioner Almunia, “competition policy is not about preventing the rise of vibrant and competitive European champions – far from it. On the contrary, enforcement of competition rules – including merger control – is a vital tool for public authorities to create the best possible conditions for firms to do business and to help the economy grow”¹.

The French government, or at least its vocal economics minister, A. Montebourg, disagreed that the application of merger control rules to the restructuring of Alstom would indeed foster the development of European champions. The French government intervened in the restructuring of Alstom but remained frustrated that the merger control rules would not allow the implementation of the plan that, in its opinion, would have lead to the development of European champions in the energy and transport sectors. The French government thus urged to EU to relax its antitrust rules. Mr Montebourg is reported as having stated that “ The rules have to now change after this story, because we need to make champions”².

Commissioner Almunia was not amused and expressed dissatisfaction at these interventions, describing them as the sign of a “protectionist threat” that he needed to respond to³ and added that the arguments used by the French government were “not the more reasonable ones”.

Such exchange of strong words on the interplay between competition enforcement and the intervention of the member states towards industry is not unusual. Discussion arose just a few months ago about the proposed acquisition of AstraZeneca by Pfizer and in numerous cases in the last few years (including Cadbury/Kraft, HPV/Unicredito, Eon/Endesa, OMV/Mol, Arcelor/Mittal and many others). These exchanges can of course be seen as a ritual in which

¹ Speech delivered at Fordham, Sept 8, 2011, available at http://europa.eu/rapid/press-release_SPEECH-11-561_en.htm?locale=en.

² As reported for instance in the Wall Street Journal on June 26, 2014.

³ As reported for instance by MLex on June 24, 2014.

member states and the competition consumer find it politically opportune to reaffirm their position towards their respective constituencies⁴.

But these exchanges challenge some fundamental principles of merger control and public policy towards industry and these principles might deserve a better hearing than merely the reaffirmation of ideology. The purpose of this short essay is thus to contribute to the policy discussion⁵ on the underlying principles. In what follows, we (i) first delineate the scope of the disagreement between the Commission and its critics and (ii) second discuss some recent evidence on the merits of their respective positions.

We organise the discussion (in section 1) by characterising the current position of the Commission on public policy towards industry and the interplay between competition enforcement and these policies. We then describe the main challenges to this position by the Commission's critics and identify five issues for discussion, namely (i) the scope of the public policy concern raised by the nationality of the acquirers in international transactions, (ii) the scope for support to strategic sector, (iii) the need to respond to foreign support in strategic sectors, (iv) the implementation of merger control rules which allow for the emergence of champions and (v) the implementation of merger control rules which give companies from small member states the same opportunities as those from large member states. Each of those issues is discussed in turn (section 2 to 5).

Overall, we conclude that in most instances when there is evidence in support of the arguments put forward by the critics of the Commission, these arguments can be addressed in the context of the current rules. What is required is thus

⁴ Indeed, even back in 1991, when the merger regulation was just adopted, Commissioner Brittan stated in an interview : "I don't like talking in slogans. I don't know what a European champion is. If you mean we should follow policies that enable European industries to be competitive and strong, I'm all for that. But I happen to believe that having an effective competition policy is as important as any other policy one could pursue. Of course, on top of that, there are a whole range of other policies, many of which are not in the hands of the Commission at all. Fiscal policy, training, industrial relations, maintaining low inflation. All of these things affect the health of industry more than anything else." WSJ, October 14, 1991

⁵ There is indeed a large policy (and academic literature) on these issues. See for instance, the OECD policy roundtable (2009).

possibly more of a change in enforcement than a change in the rules themselves. In particular, we find, first, that there may be a legitimate concern about the nationality of acquirers with respect to the location of research and development facilities but that this concern can probably be addressed by adopting a wider interpretation of Art 21(4) of the merger regulation. We observe, second, that there may be more scope for the identification of strategic sectors but that the grounds on which intervention can be justified towards these sectors are likely to be recognised by state aid rules. Third, we find that the substantive criteria for the assessment of mergers denies a number of transactions that would raise efficiency and profits over and above the consumer harm that they entail but that the current enforcement is likely to reinforce the bias against efficiency enhancing transactions. Short of changing the substantive criteria, much could be done by ensuring that a balanced hearing is given to efficiencies. Finally, we conclude that while it may be appropriate to give companies from small member states the same opportunities as those from larger member states, this would require a decision rule in which, unlike the current one, consumer harm in one country is balanced against consumer benefits in other country. This involves a more significant change in policy.

2. The current policy on champions and competition enforcement

The current policy of the Commission has been well articulated in a number of policy documents, like the Commission's submission to the OECD roundtable on national champions (2009)⁶. Its main features can be summarized as follows :

- Focus industrial policy on horizontal instruments. Support to industry should focus on providing adequate infrastructure and general conditions conducive to investment. In addition, there is no conflict between competition enforcement and support to industry as ensuring competitive markets is the best way to foster the development of productivity and firms that are competitive internationally (see the statement from Commissioner Almunia above).

⁶ See also Maincent and Navarro (2006)

- Among horizontal policies, focus on R&D support. The state aid R&D guidelines explicitly recognize the benefits from R&D support by member states and provide a framework to balance the benefit from R&D support against the potential distortions of competition.
- Stay away from the definition of strategic sectors. The market knows best and government can be captured⁷.
- Stay away from targeted support to European champions, possibly because of with mixed results in the past (Airbus, Ariane vs Esprit and HDTV, see Maincent and Navarro (2006) for a discussion). For instance, the Commission stated (OECD Submission) : “However, it should also be noted that the Commission does not see a special need to foster "national champions". Every nation can be a winner in the single market, with which the concept of merely "national" champions is somewhat in tension. In contrast, a recent call for the creation of "European Champions" is more in keeping with the spirit of the internal market. But even regarding "European Champions", the Commission does not see any need to foster them in an interventionist way”.
- In any event, competition and state aid rules have primacy: “Moreover, the concept of any kind of "champion" cannot be invoked, explicitly or implicitly, as a justification for setting aside the rules on anti-trust, mergers and State aid”⁸.
- In this spirit, the Commission has enforced state aid rule towards national Champions – with a strong presumption that targeted support is selective (and hence likely to lead to a distortion of competition). The Commission often deems support unlawful and seeks reimbursement.
- Regarding the interplay between support to industry and merger control rules, the merger regulation focuses on consumer harm and does not allow for the consideration of other policy objectives at the EU level. In

⁷ Commissioner Kroes indicated in a speech in 2006 “I am all for champions – European champions who can go out and win on global markets. But let us be under no illusion : it is markets and not politicians that pick the winners”, Villa d’Este Forum, Cernobbia, 2nd September 2006, available at http://europa.eu/rapid/press-release_SPEECH-06-480_en.htm?locale=en

⁸ Commission submission to the OECD (2009).

The nationality of the acquirer does not matter. The regulation allows for other public policy considerations at the national level to play a role under Art 21(4). The regulation explicitly mentions prudential rules, security and plurality of the press as valid public policy grounds for intervention but allows potentially for others at the discretion of the Commission. Art 21(4) of the merger regulation⁹.

This policy has been challenged on different fronts by various constituencies and can be summarized as follows;

- The nationality of the owners (decision makers) matters and should be taken into account. This argument was prominent in Alstom/GE/Siemens case but also in cases like Pfizer/Astra Zeneca, OMV/Mol, Arcelor/Mittal, HPV/Unicredito, Cadbury/Kraft, Eon/Endesa and others.
- Some sectors are “strategic” and the government should not shy away from identifying and supporting those sectors. Support should be allowed under EU state aid rule. EU merger control rules should take this into account.

⁹ A number of countries exercise oversight over transactions involving domestic firms. France introduced an administrative law (“Décret 17391”) in 2005 which adds a layer of control with respect to acquisitions affecting defense and national security (broadly understood). This law is often referred to as the Yoghurt Law (as it was adopted when it was rumored that Danone could be taken over by Pepsi Co, but also when Gemplus, the smart card producer, was acquired by Texas Instrument). This law falls squarely within the exception of Art 21(4) and its scope is wider for acquisitions by non EU interests. There is limited transparency on the decisions but it is understood that commitments to maintain activities in France have been routinely negotiated (see Neven, 2010). The scope of the law extended on 14/5/2014 (and nicknamed as the Alstom law) to include sectors linked with energy security, water, transport, electronic communication and public health. The conformity of this extension with Art 21(4) is currently examined by the Commission (also with respect to internal market rules on the free mobility of capital)

Germany has a law enacted in 2009 which only applies to non EEA investor. The only ground for intervention is public order and security.

In the US, control is exercised by the Committee on Foreign Investment (CFIUS) under the Foreign Investment and National Security Act. The only public policy ground of intervention is national security (broadly understood to include critical technologies). In 2012, The Committee reviewed 144 transactions, undertook an investigation in 44 cases. One divestment order was imposed on a Chinese investor in a wind park next to a military airfield (CFIUS, Annual report to Congress, December 2013).

- Foreign governments are targeting sectors and particular companies (with China and South Korea often mentioned as cases in point). Europeans are naïve and should do the same. EU state aid rules should allow for this.
- EU antitrust rules prevent the emergence of “champions”. As mentioned above, this was an explicit criticism of A. Moutebourg in the Alstom saga. According to him, the preferred option for Alstom would have been a tie up with Siemens which was not feasible because of EU merger control rules.
- EU antitrust rules are biased against companies from small member states. This concern was expressed in particular in the context of the attempted merger between Volvo and Scania¹⁰ in 2000 (see Horn and Stenneck, 2001, 2005).

In what follows, we consider each of these criticism in turn.

3. The nationality of acquirers

In principle, the nationality of shareholders should not affect the efficiency of corporate control. From the perspective of mainstream corporate finance, institutions and competences do not vary according to nationality. And indeed, it is tempting to dismiss the case in favour of restricting ownership on this basis alone.

At the same time, it strikes with intuition that domestic and foreign investors or managers may take different business decisions. This may arise because of bounded rationality. The informational underpinnings of an investor’s decisions are circumscribed by his or her social context, which implies that rationality is “bounded” by social origins. That is to say that investors and managers from different countries might take different decisions simply because they have been raised in a different environment. It may also arise because they have different objectives functions and motivations at least to the extent that such objectives can be pursued besides the maximisation of returns

¹⁰ Case COMP/M.1672 Volvo-Scania (2000)

There is indeed some evidence (see Neven, 2010 for a discussion) that managers from similar cultures have different goals, different ethical standards and respond to different incentive mechanisms but the implications of this observation are less clear. Arguably, domestic managers and shareholders may have a better understanding of local conditions and constraints and their decisions may be better understood by local constituencies. But managers and shareholders from different cultures may have a better understanding of foreign clients and competitors. That is also to say that domestic shareholders and managers will not necessarily take better decisions in terms of long term profitability.

Indeed, the cross section evidence on whether profitability or productivity growth is affected by whether firms are owned by domestic or foreign constituencies is difficult to interpret (see Griffith, 2005). The evidence on whether the performance of firms following a merger is significantly affected by whether the acquirer is foreign is also inconclusive (see Mueller et al (2002) for instance). By contrast, it would seem that what affect productivity growth is not so much whether an entity is owned by a foreign or a domestic constituency but rather whether it belongs to a multi-national firm (Griffith, 2005).

On the face of it, it would thus appear that there is no evidence supporting the view that the nationality of the acquirer should affect merger control decisions. There is however an intriguing observation with respect to R&D facilities. There is a well-known home bias in the location of R&D, which seems to persist despite globalization. For instance, Griffith et al (2004) find that in the chemical, pharmaceutical and service sectors, UK owned multi-national firms have a significantly larger R&D intensity than foreign owned multinationals. Cohen et al (2009) consider find a strong concentration of R&D and patents in the home countries of the largest firms in the telecom and automobile sector.

The question then arises whether there may be a legitimate policy concern about the identity of the acquirer with respect to the location of R&D centres. In this respect, there is a large literature confirming that R&D might generate localized spillovers so that the relocation of R&D following a foreign acquisition will have negative external effects that may justify a public policy intervention. The recent commitment by Pfizer to maintain 20 % of its R&D activity in the UK (for

five years) in the event of an acquisition of AstraZeneca seems to be a response to this public policy concern¹¹.

One can also wonder whether interventions by member states to avoid the relocation of R&D activities would be consistent with Art 21(4) of the merger regulation¹². As mentioned above, beyond national security, the plurality of the press and prudential stability, the Commission has discretion in delineating the scope of application of Art 21(4). There is at present limited case law providing guidance on the application of this Article and a very small number of cases of violations of the notification requirement imposed on the member states. Rather than turning a blind eye, it would be preferable for the Commission to define a test for the application of Art 21(4), which would rest on the presence of significant market failures or the presence of significant external effects imposed by the transaction. Within such an interpretation, the Commission could allow and oversee the constraints that member states impose on the relocation of R&D facilities.

4. Strategic sectors

The Commission's reluctance to identify strategic sectors or particular firms seems to rest on the premise that "markets" have superior information and that governments can be easily captured by particular interest. It should be emphasized at the outset that concerns about capture are more plausible for particular firms or project than for entire sectors (see Aghion and Roulet, 2013)¹³. More importantly, there is a clear scope for public policy interventions

¹¹ <http://www.theguardian.com/business/2014/may/13/pfizer-astrazeneca-uk-job-cuts-mps-hostile>

¹² Policies which discriminate according to nationality of the acquirer might be in tension with some bilateral investment treaties (even if those treaties typically focus on preventing ex post hold up rather than ensuring non discrimination ex ante).

¹³ The notion that markets are necessarily better at picking particular firms than governments can still be challenged. Seabright (2005) argues that executives making decision on what project to support and finance might suffer from biases that are comparable to those of public authorities. In his view, "recent years have seen no shortage of examples in which the executives of private firms have displayed all the vanity, short sightedness and obsession with technology and

at the level of particular sectors, which rests on at least two grounds. The most plausible concept of a strategic sector relates to the clusters or industrial districts that benefit from agglomeration economies (see Dosi et al., 2009). It has been long recognised that governments can solve coordination problems among potential members of a local network and more generally help internalise the external effects that arise among them (see Spector, 2009 for a discussion). These policies have also been widely implemented in a number of countries¹⁴ and useful experience has been accumulated on the most effective forms of public support (see Rodrik, (2004)). The potential benefits from the development of clusters has also been recognised by state aid control rules, in particular the guidelines on regional aid¹⁵.

If state aid rules appear adequate, the question still arises whether merger control rules should not take into the potential benefit that a merger may entail in terms of the development of clusters. This would actually require for the Commission to take into account the efficiency benefits from merger for other firms than the merger partners (competitors as well as suppliers of complements in the context of a localised network). As far as I can tell, the Commission has never considered external efficiencies. However, it seems that the wording of the merger regulation (in particular Art 2.1¹⁶) and of the horizontal merger guidelines (in particular § 77¹⁷) would not prevent the Commission to take them into account.

visibility that can characterise public projects at their worst: names such as Vivendi Universal, Enron and WorldCom spring irresistibly to mind". However, he finds that private and public sponsorship differ to the extent that public support is biased towards incumbents and innovation comes, at least in a number of sectors, from new firms.

¹⁴ See www.clusterobservatory.eu, which provides comprehensive information on clusters across the EU.

¹⁵ See Guidelines on regional State aid for 2014-2020 (Official Journal 2013/C 209/01), in particular section 3

¹⁶ Art 2.1 (b) refers to the development of technical progress without specifics how it takes place. Council Regulation No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, OJ L 24/1

¹⁷ §77 refers explicitly to the efficiencies that are likely to enhance to ability and incentive of the merged entity to act pro-competitively but does not exclude other mechanisms through which consumers could benefit. (Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, OJ, 2004/C 31/03)

The second ground for support relates to the notion that government can promote innovation by providing indiscriminate support to all firms in a sector (independently of their location and in the absence of network effects). The support will make competition more intense and provide firm with incentives to escape competition by differentiation vertically (see Aghion et al. (2012) who also provide evidence that such policies have been effective in China). Even if such policies have not been implemented in the EU, current state aid rules would presumably consider them favourably, as least if they are implemented across a number of member states. The recent revision of the guidelines on the assessment of important projects of common European interest would in particular seem to offer a framework which is flexible enough to accommodate such support¹⁸, but it might require a change in enforcement and a greater willingness by the Commission to consider the potential efficiencies of these schemes.

5. Strategic trade policy

The strategic trade policy literature has long recognised that a country could benefit by supporting domestic firms because by doing so it would shift profit away from foreign competitors (see for instance Brander, (1995)). All countries involved will however typically be better off if they abstain from providing support to their domestic firms. Still, if a foreign government provides support, the best reply of the domestic government is also to give support, so that governments could be locked into prisoner's dilemma. The Subsidies and Countervailing measures agreement (SCM) of the WTO is precisely meant to ensure that its member countries refrain from unilaterally granting subsidies and hence escape from this prisoner's dilemma. Whether the WTO provides a effective discipline on subsidies is a broader question on which we do not offer a

¹⁸ Criteria for the analysis of the compatibility with the internal market of State aid to promote the execution of important projects of common European interest, OJ C(2014) 3290, available at http://ec.europa.eu/competition/state_aid/modernisation/ipcei_communication_en.pdf

view but merely not that according to some observers it leads to significant type I and type II errors (situation where the subsidies are allowed when they lead to important distortions as well as situation in which subsidies are banned in the presence of a sound public policy justification, see for instance Sykes, 2010)

The EU is naturally wary of this rationale for support given that arguably, the prime objective of the EU state aid control policy is to avoid strategic trade policies among the member states (such that support in one member state leads to a distortion of competition with firms located in other member states). A number of guidelines (like the R&D&I and IPCEI guidelines) still include a so-called matching clause, which allows for greater support when third countries also provide support¹⁹. To the best of our knowledge, this matching clause has however never been used and it is indeed very likely to be contrary to WTO rules²⁰. The question remains however whether the EU could not provide subsidies in reaction to the subsidies provided by foreign governments that would remain in conformity with WTO rules. This is likely to be a narrow path and indeed should probably not be encouraged given the merit of a multilateral discipline on subsidies.

¹⁹ The matching clause in the recently adopted R&D&I guidelines reads as follows: “In order to address actual or potential direct or indirect distortions of international trade, higher intensities than generally permissible under this framework may be authorised if, directly or indirectly, competitors located outside the Union have received in the last three years or are going to receive aid of an equivalent intensity for similar projects. However, where distortions of international trade are likely to occur after more than three years, given the particular nature of the sector in question, the reference period may be extended accordingly. Where possible, the Member State concerned will provide the Commission with sufficient information to enable it to assess the situation, in particular the need to take account of the competitive advantage enjoyed by a third country competitor. Where the Commission does not have evidence concerning the awarded or proposed aid, it may also base its decision on circumstantial evidence.” Art 92 of the Communication from the Commission, Framework for State aid for research and development and innovation (2014/C 198/01).

²⁰ Following the panel ruling on *European Communities – Measures affecting trade in commercial vessels*, WT/DS301, April 22, 2005. In this case, the panel found that the EU has violated its obligation under the SCM agreement by acting unilaterally in providing subsidies to the European shipbuilding industry in response to what I perceived to be unlawful subsidies granted by Korea.

6. More efficient firms through mergers

As mentioned above, A Montebourg explicitly challenged EU merger control rules, stating that his preferred solution for the restructuring of Alstom would not be feasible because of EU merger control. Such critics would prefer merger control rules to allow for more champions, or in other words to allow for mergers that give rise to more efficient and more profitable firms even if they would harm consumers. This is a fundamental criticism that needs careful consideration. In what follows, we first discuss (section 6.1) the important role that the evaluation of efficiencies play when merger control operates with a consumer harm standard as in the EU. We subsequently review (section 6.2) the practice in this respect and conclude (section 6.3)

6.1. The role of efficiencies in the implementation of a consumer surplus standard

The EU merger control rules are supposed to prevent mergers that would lead to a significant impediment to effective competition (Art 2 of the merger regulation) and this substantive criteria is (unanimously) understood as referring to consumer harm. This is one particular substantive criteria. The obvious alternative would be to consider total welfare, namely the change consumer surplus and profits²¹ and it is useful to describe the consequences of the Commission's choice of substantive criteria in terms of the selection of mergers. This is illustrated in Figure 1. The change in consumer surplus implied by a merger is represented on the vertical axis and the change in welfare on the horizontal axis. Any merger can be represented as a point in this graph and the population of potential mergers belongs to the red ball. The change in welfare is equal to the sum of the change in profit for the merging firms, the change in profit of competitors and the change in consumer surplus. In standard models of horizontal mergers, in the absence of efficiencies, consumer surplus will fall, the profit of the merging firms and those of competitors will increase but overall welfare falls (as the mere exercise of market power always leads to a

²¹ Or more generally, any weighted average of the change in consumer surplus and profit.

fall in welfare). These mergers will be found in the lower left hand quadrant²². In all other areas, mergers will require some efficiencies; for mergers above the horizontal line, prices falls (consumers gain) and this can only arise following a horizontal merger if there are some efficiencies (so that the fall in marginal cost compensates for the increased margins). For mergers in the lower right hand quadrant, welfare increases and this can only arise if there are some efficiencies (because the mere exercise of market power always reduces welfare)²³. Assuming that the Commission correctly identifies the characteristics of mergers, it will allow all mergers in the upper right hand quadrant²⁴. Those mergers lead to an increase in consumer and welfare²⁵. However there are mergers that lead to an increase in welfare but not in consumer surplus (in the area hatched in green). Mergers in this area lead to an increase in profit that exceeds the fall in consumer surplus. As noted above, these mergers necessarily involve efficiencies and would increase aggregate profits and, to a greater extent, the profit of the merging firms (as in the presence of efficiencies, the profits of the merging firms is likely to increase by more than the profit of competitors). These efficiency enhancing mergers are deterred or prohibited under the substantive criteria of the Commission.

Some important observations can be made from this figure; first, the assessment of efficiencies by the Commission is a matter of *degree* ; mergers in the upper right hand quadrant (allowed by the Commission) and those in the lower quadrant (prohibited by the Commission) all involve efficiencies albeit to a different degree. Indeed, in order to allow *any* horizontal merger (in the upper right hand quadrant), the Commission must have a presumption that efficiencies

²² Note that some mergers in this area might not be profitable.

²³ In other words, efficiencies are a necessary and sufficient condition for an increase in welfare and a necessary (but not sufficient) condition for an increase in consumer surplus.

²⁴ Note that some mergers in this quadrant will not be proposed because the increase in profit for the merging firms will not be sufficient. These mergers are likely to be found above the blue line.

²⁵ Note that the Commission might also allow mergers in the upper left hand quadrant. These mergers will be such that overall profits fall. These mergers might still be proposed if the profit of the merging firms increases but by less than the absolute value of the profit of the competitors.

will accrue²⁶. Hence, the question that the Commission faces is not whether there are efficiencies but whether these efficiencies are large enough to conclude that consumer will not be harmed. The level of efficiency that will be deemed sufficient to conclude that the merger will not reduce consumer surplus will also be merger specific. The consequence of a bias in the evaluation of efficiencies can also be illustrated: if the Commission has a higher standard of proof with respect to the evaluation of efficiencies than with respect to the evaluation of anti-competitive effects, mergers that increase both consumer surplus and welfare will be prohibited. This is illustrated by the area hatched in purple in Figure 1. Hence, the evaluation of efficiencies is both pivotal to the implementation of a consumer surplus standard and the benchmark is specific to each merger.

The central role that the evaluation of efficiencies should play in the implementation of a consumer surplus standard can also be contrasted with the role that it would play with respect to a total welfare standard. In this instance, the question would be whether a merger falls to the right or the left of the vertical axis. However, at least for those mergers that fall below the horizontal axis, the question would be the same for all mergers and merely whether efficiencies are likely to be positive. Indeed, the triage between welfare enhancing and welfare decreasing mergers (when consumers are harmed) depends solely on the existence of efficiencies²⁷.

One could of course wonder whether in light of these difficulties and given economists' prior in favour of total welfare, a change in standard would not be appropriate. This is a wider question that involves different aspect of enforcement, including the access to information and the incentives of the constituencies to provide information or influence the agencies and their ability to commit²⁸. A discussion of this issue would go beyond the scope of this essay.

²⁶ The issue is particularly stark when the Commission uses merger simulations and need to define a tolerance for predicted price increases, which reflects its presumption about the reduction in marginal cost that might compensate for this price increase. See also Farrell and Shapiro (2010).

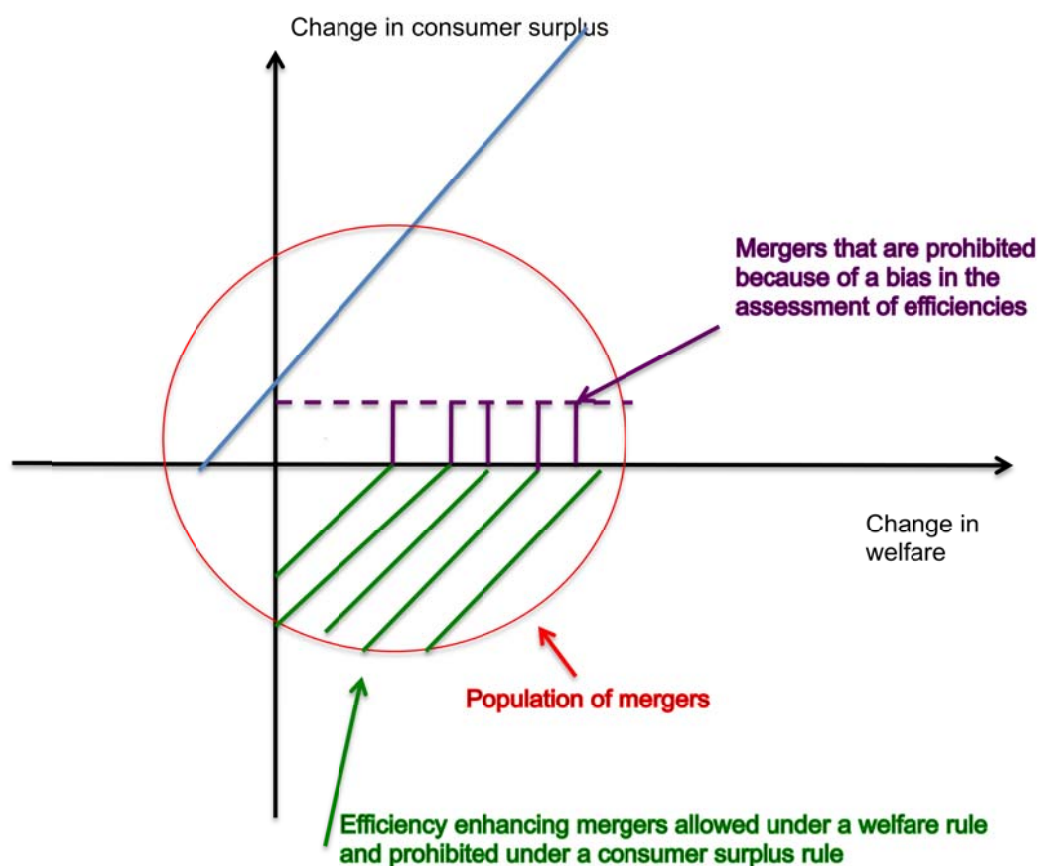
²⁷ As efficiencies are a necessary and sufficient condition for an increase in welfare.

²⁸ See Besanko and Spulber (1993) and Neven and Roeller (2005) for a discussion of these different aspects.

Suffice it to note that, to the best of our knowledge, only Canada has experimented with a total welfare standard but subsequently reverted to a consumer surplus standard.

Still, without questioning the standard itself, it is clear that from the previous discuss that any downward bias in the evaluation of efficiencies will widen the discrepancy between the outcome of a consumer surplus and total welfare standard (the area hatched in purple on figure 1). It is thus “important that efficiencies, investment and innovation play a proper role under a consumer surplus standard” (Roeller, 2011). In addition, as discussed above, under a consumer welfare standard, the Commission should in principle evaluate the quantitative significance of efficiencies in all cases (and the threshold value beyond which the case should be cleared will vary from one case to the other).

Figure 1. Consumer surplus and total welfare standard



6.2. The Commission's practice

In assessing whether the Commission is giving a fair hearing to efficiencies, it is first striking observed that the over almost 25 years of enforcement, the Commission has never accepted efficiencies in a way that was instrumental for a final decision²⁹. Even if the proportion of transaction in which efficiencies are truly sufficient to outweigh anti-competitive effects is small, one would expect the Commission to have stumbled over few among the 7 000 transactions that it has reviewed since 1989.

In the five years that followed the adoption of a change in the merger regulation that has arguably given more prominence to efficiencies in 2004, static efficiencies have only been claimed in 6 phase II cases out of 37 and they have been accepted as relevant in 3 of them (see Roeller, 2011)³⁰. For period 2009 to 2013, Seabright (2014) reports even lower rates of acceptance. Both Roeller (2011) and Seabright (2014) find that dynamic efficiencies play an even less significant role.

This apparent neglect of efficiencies could be the result of the very high standard of proof that the Commission applies to the claims by the parties. Crane (2011) concludes that there is indeed a strong asymmetry between the standard that the Commission and the FTC applies to efficiencies, on the one hand, and anti-competitive effects on the other. Gonzales-Diaz (2012) who reviews a number of recent decisions by the Commission reaches the same conclusion³¹.

In what follows, we review some of the key decisions in which the Commission reviewed efficiencies since 2005. In Inco/Falconbridge (M4000), a merger between two mining companies, the Commission agreed with the parties that the integration of the parties' mines, mills, smelters and refineries would allow for

²⁹ Except possibly in the Shell/Nynas/Harburg Refinery (M6360) case, which is however a failing division case. See http://europa.eu/rapid/press-release_IP-13-290_en.htm. The decision is not yet published.

³⁰ It is puzzling that efficiencies are claimed in such a low proportion of cases. According to Roeller (2011), this arises because parties and their legal advisors are concerned about efficiency offenses (such that evidence of efficiencies is used to argue that competitors will be marginalised) or more generally concerned about the fact that claims about efficiencies will send the signal that the parties are not confident with respect to their evidence on the lack of anti-competitive effects.

³¹ Kokkoris (2012) argues that the OFT has developed a more balanced standard, in particular following the clearance of the Global Radio UK Ltd v GCap Media Plc case for which efficiencies were instrumental. See also Lapr v te (2014).

optimisation of capabilities of these assets, thereby increasing production and lowering cost on a sustainable basis over the longer term. But the Commission found that the efficiencies were not merger specific because they could have been realized in the context of a joint venture and that efficiencies would not be sufficiently passed on because some of efficiencies would accrue across markets and in particular in market unaffected by the transaction in which the parties faced little competition. However there is no quantification of the extent of pass through and of the extent to which consumers would still benefits over all³².

In Kornas/AD Cartonboard (M 4057), the Commission found that the parties would achieve significant efficiencies that were likely to be passed on. Rather surprisingly, the Commission acknowledged that an assessment of the efficiencies was difficult in phase I but could conclude on the basis of a superficial analysis³³ that the parties had established to the required standard that efficiencies would be passed on to consumers.

In Metso/Aker Kvaerner (M 4187), the Commission acknowledged the claim by the parties (supported by customers) that the merger would enable the parties to better integrate the different parts of a paper mills (in which they had different specialization). However, the Commission dismissed the significance of these efficiencies simply because a majority of customers³⁴ are reported as

³² In addition to the fact that the Commission seems to presume, incorrectly, that pass-through will be lowest when firms are in quasi-monopoly and increase with the degree of competition. In general, the pass-through actually falls with the number of competitors but might increase with the degree of substitution between products. The Commission also dismissed the evidence put forward by the parties in Western Digital Ireland/Viviti Technologies (M6203), partly on the ground that pass-through would be insufficient in light of the fact that market would be a duopoly. There again the argument of the Commission is a best incomplete. For a discussion of pass-through, see Farrell and Shapiro (2010).

³³ "The submission by the parties raises a lot of issues, which cannot be fully assessed within the context of a first phase investigation, ... Nevertheless, it appears realistic to assume that the allocation of production among the increased portfolio of machines will indeed allow the merged entity to increase overall production on the machines In light of the above-mentioned term sheet agreement with Tetra Pak and on the general absence of concern about the transaction among customers, the Commission considers that the parties have sufficiently established that this category of efficiencies is likely to occur and be passed on to consumers" (§62-63)

³⁴ As often, the Commission does not report what the majority was and how many customers responded.

having stated that in their view the improvement in quality would not compensate for the risk that prices would increase. I can really wonder whether customers are a reliable source of information and have a sound judgment both the quantum of efficiencies that would result from the integration plans that are private to the merging firms and the significance of the price increase that would arise (given that in the case at hand, there was a prospect that the merging entity would be in a better position to challenge the market leader).

In UPM/Mylykowski (M 6101), the parties submitted extensive evidence on efficiencies that would arise from the reallocation of output across different paper mills. The evidence was developed using existing methods that the parties used to allocate output among their respective portfolio of plants pre merger. The results from these calculations could be validated by past experience. The Commission (§167) however chose to dismiss the efficiencies on the ground that even if they would reduce variable cost, the parties had not provided direct evidence of pass-through. The Commission even question whether there will be any pass-through (“Under those circumstances it is particularly unclear whether any efficiencies would be passed on to the customers”). This is quite surprising as the circumstance in which efficiencies are not passed-through (like perfect competition with homogenous products) can be seen as intellectual curiosities. Efficiency claims were subject to greater scrutiny in the UPS/TNT (M6570)³⁵ and Deutsche Borse/NYSE Euronext (M 6166) cases. In UPS/TNT, the Commission has only validated the efficiencies claimed by the parties with respect to the air network and dismissed those with respect to the integration of the pick up and delivery and long haul terrestrial networks. Still, it is not clear on what ground the Commission decided that the former efficiencies should be considered verifiable. Both studies were undertaken ex ante using the methodologies that

³⁵ The decision is not published yet, but the Commission published a summary: Summary of Commission Decision of 30 January 2013 declaring a concentration incompatible with the internal market and the functioning of the EEA Agreement (Case COMP/M.6570 — UPS/TNT Express), OJ, 2014/C 137/05. The Commission stated in that summary that the decision has underestimated the extent of pass-through of efficiencies. This was later corrected. Corrigendum to Summary of Commission Decision of 30 January 2013 declaring a concentration incompatible with the internal market and the functioning of the EEA Agreement (Case COMP/M.6570 — UPS/TNT Express), OJ, 2014/C 187/10

the parties used in the optimization of their network (whether air or terrestrial). The Commission also seems to quibble with the level of details of the estimation of efficiencies, despite the fact that the parties had considered that the level of details for sufficient for the purpose of planning the transaction. Yet, for some countries, the parties provided very detailed efficiency calculations that the Commission still ignored.³⁶ In addition, the Commission dismisses past experiences of the integration of terrestrial networks on a very general ground, namely that the incremental benefits from economies of density can be expected to fall as the network grows.

In NYSE/Euronext, the Commission face two main efficiency claims, namely that that the merger would lead to a significant reduction in collateral requirements for its clients and that the merger would improve liquidity. The Commission accepted the former but significantly reduced the estimated benefits, as it pointed out, rightly, that the benefits should be estimated in terms of the opportunity cost of holding cash or securities posted as collateral (and not merely as the gross value of the reduction in collateral). With respect to the claim on liquidities, the parties provided evidence relating to past mergers. The Commission considered this evidence in detail both in terms of its technical aspects (a regression analysis in which the effect of past mergers was identified) and in terms of its interpretation (whether the circumstances has changed significantly since the past mergers).

In addition to horizontal mergers, the Commission has also considered efficiencies in vertical or conglomerate transactions, like TomTom/Tele Atlas (M 4854), Nokia/Navteq (M 4942) or Intel/MacAfee (M5984). These non horizontal transactions raise another intricate issue with respect to efficiencies as the traditional analytical approach of the Commission in horizontal cases,

³⁶ Of course, one cannot help observing that if the Commission had acknowledged the presence of efficiencies in the ground network, customers in unaffected markets (for domestic and standard international services) would have benefitted from the transaction. The Commission would thus have had to consider cross-market efficiencies and might have come to the conclusion that a vast majority of the customers (using both the international express as well as other services) would have benefitted from the transaction. This case actually provides a good example of a situation in which inefficiencies are inextricably linked across markets and in which customers in affected and non affected markets are substantially the same.

such that the analysis of anti-competitive effects can be separated conceptually from the effect of efficiencies is not appropriate. In vertical cases, the sources of the efficiency and the potential for anti-competitive effects cannot be neatly disentangled. Intel/McAfee is a case in point. This transaction involved the integration between the CPU (hardware) and security software and the parties argued that integration would allow them to develop better solutions than what could be achieved in the context of cooperation (that they had tried before). The anti-competitive effects in this case arise from the potential foreclosure of other security software producers. Of course, to the extent that efficiencies require a tight integration, they will also imply some foreclosure effect and access remedies (for other software producers) would run the risk of jeopardizing the efficiencies (by reducing the scope of integration). That is also to say that parties will be wary of arguing the presence of efficiencies in such cases as it will draw attention to anti-competitive effects and could be turned into an efficiency offense.

6.3 Some conclusion on efficiencies

What appears striking is the general ground on which the Commission tends to dismiss (or occasionally approve) efficiencies, despite the fact that as mentioned above efficiencies are a matter of degree in the application of a consumer surplus standard and the benchmark (the required efficiencies to compensate for anti-competitive effects) varies from one case to the other.

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